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Office - Supreme Court, U. S.
FILED
JUN 12 1952

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 123.

KAISER-FRAZER CORPORATION,

Petitioner,

against

OTIS & CO.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN W. DAVIS,
Counsel for Petitioner,
Kaiser-Frazer Corporation.

MARK F. HUGHES,
WALSTON S. BROWN,
GEORGE EDWARD COTTER,
HELMER R. JOHNSON,
VINCENT R. FITZPATRICK,
RICHARD OWEN,
Of Counsel.

INDEX.

	PAGE
Opinions Below	2
Jurisdictional Statement	2
Questions Presented	2
Statute Involved	2
Statement	3
Reasons for Granting the Writ	6
I.—The decision of the Court of Appeals that the contract is illegal and unenforceable under the Securities Act of 1933 is in direct conflict with a decision of this Court. It also conflicts with other decisions of this Court with respect to the enforceability of contracts	8
II.—The Court of Appeals disregarded Rule 52(a) of the Federal Rules of Civil Procedure and the decisions of this Court construing it	13
III.—The Court of Appeals incorrectly interpreted the requirements of the Securities Act of 1933 as to the presentation of factual data in a prospectus	19
Conclusion	22
Appendix "A"	1a

DARK PAGE BLEED THRU

TABLE OF CASES.

	PAGE
A. G. Frost & Co. v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38 (1941)	6, 8
Allman v. *Winkelman*, 106 F. 2d 663 (9th Cir., 1939)	10
Bach v. *Friden Calculating Machine Co.*, 148 F. 2d 407 (6th Cir., 1945)	18
Broome v. *Speak*, [1903] 1 Ch. 586	16
Brown v. *Quinlan*, 138 F. 2d 228 (7th Cir., 1943)	18
Bruce's Juices, Inc. v. *American Can Co.*, 330 U. S. 743 (1947)	9
Campbell v. *Campbell*, 170 F. 2d 809 (D. C. Ct. of App. 1948)	18
City of Sumter v. *Spur Distributing Co.*, 110 F. 2d 649 (4th Cir., 1940)	18
Deitrick v. *Standard Surety & Casualty Co.*, 303 U. S. 471 (1938)	11
Devine v. *Zimmerman*, 133 F. 2d 850 (8th Cir., 1943)	16
Graver Manufacturing Company v. *Linde Company*, 336 U. S. 271 (1949)	14
Hammond v. *Schappi Bus Line*, 275 U. S. 164 (1927)	18
Helbush v. *Finkle*, 170 F. 2d 41 (9th Cir., 1948)	18
Kelley v. *Everglades District*, 319 U. S. 415, 418 (1943)	18
Marlborough Corporation v. *United States*, 172 F. 2d 787 (9th Cir., 1949)	16
Mayo v. *Canning Co.*, 309 U. S. 310 (1940)	18
McIntosh v. *Wiggins*, 123 F. 2d 316 (8th Cir., 1941)	16
Muschany v. *United States*, 324 U. S. 49 (1945)	9
New Amsterdam Casualty Co. v. *Jones*, 135 F. 2d 191 (6th Cir., 1943)	10
Otis & Co. v. *Securities and Exchange Commission*, 106 F. 2d 579 (6th Cir., 1939)	21
Rex v. *Kylsant*, [1932] 1 K. B. 442	16

PAGE

Steele v. *Drummond*, 275 U. S. 199 (1927) 10

Twin City Pipe Line Co. v. *Harding Glass Co.*, 283 U. S. 353 (1931) 11

United States v. *Yellow Cab Co.*, 338 U. S. 338 (1949) 14

Walling v. *General Industries, Inc.*, 330 U. S. 545 (1946) 17

STATUTES AND RULES.

Federal Rules of Civil Procedure
Rule 52(a) 2, 5, 7, 13, 14, 16, 17, 18

Investment Advisors' Act of 1940, 54 Stat. 847 (1940) 15 U. S. C. §§80b-1-80b-21

15 U. S. C. §80b-15 (Section 215) 7, 9

Investment Company Act of 1940, 54 Stat. 789 (1940) 15 U. S. C. §§80a-1-80a-47

15 U. S. C. §80a-46 (Section 46) 7, 9

Judicial Code
28 U. S. C. §1254(1) 2

Public Utility Holding Company Act of 1935, 49 Stat. 838 (1935) 15 U. S. C. §§79-79z

15 U. S. C. §79z (Section 26) 7, 9

Securities Act of 1933, 48 Stat. 74 (1933), 15 U. S. C. §§77a-77aa

15 U. S. C. §77a (Section 1) 2, 3, 8, 10, 13
15 U. S. C. §77k (Section 11) 9, 11, 12
15 U. S. C. §77l (Section 12) 6, 9, 12, 19
15 U. S. C. §77n (Section 14) 9
15 U. S. C. §77q (Section 17) 2
15 U. S. C. §77t (Section 20) 12
15 U. S. C. §77x (Section 24) 12

PAGE

Securities Exchange Act of 1934, 48 Stat. 881 (1934), 15 U. S. C. §§78a-78jj

15 U. S. C. §78a (Section 1) 10
15 U. S. C. §78cc (Section 29) 7, 9

OTHER AUTHORITIES.

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Finney, Principles of Accounting, Intermediate (1944 Ed.) 20

Montgomery Auditing (7th Ed., 1949) 21

Restatement, Law of Contracts, Section 74 20

Securities and Exchange Commission, General Instructions to Form S-1, Instruction D(a) 21

Wigmore Evidence (3rd Ed., 1940), Sec. 2553 16

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Kaiser-Frazer Corporation, respectfully prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit entered on April 7, 1952 (R. 3099-3100) which reversed a judgment of the United States District Court for the Southern District of New York (R. 3087-8) in the sum of $3,120,743.51 in favor of petitioner and against respondent after a trial before the District Court without a jury.

Opinions Below.

The opinion of the District Court (R. 3057-3086), announced on July 2, 1951, has not been reported. A copy is attached hereto as Appendix A. The opinion of the Court of Appeals (R. 3089-3099) is reported in 195 F. 2d 838.

Jurisdictional Statement.

The jurisdiction of the Court is invoked under 28 U. S. C. §1254(1).

Questions Presented.

1. Does the Securities Act of 1933, 15 U. S. C. §77a *et seq.* make void an underwriting contract between an issuer of securities and an underwriter, which is valid on its face, because a registration statement or prospectus relating to said securities fails, *arguendo,* fully to comply with the provisions of the Act?

2. Under Rule 52(a) of the Federal Rules of Civil Procedure may the Court of Appeals, on issues of fact as to which there is conflicting evidence, disregard the findings of the District Court?

3. Did the Court of Appeals misinterpret the requirements of the Securities Act of 1933 as to the presentation of factual data in a registration statement or prospectus?

Statute Involved.

The statute involved is the Securities Act of 1933 (15 U. S. C. §77a *et seq.*), particularly Sections 11, 12, 14 and 17 of that Act.

Statement.

The action arose out of a contract entered into on February 3, 1948 (R. 13-31) between petitioner and three underwriters (First California Company, Allen & Co. and respondent), wherein the underwriters severally agreed to purchase from petitioner shares of its common stock.

The contract made the underwriters' obligation to accept the stock subject to certain conditions which, so far as relevant, may be summarized as follows: (1) petitioner's counsel was to deliver an opinion satisfactory to the underwriters' counsel that there were no material legal proceedings pending against petitioner; (2) the Registration Statement (including the Prospectus) filed with the Securities and Exchange Commission, pursuant to the Securities Act of 1933, 15 U. S. C. §77a *et seq.* was to comply with the Act and the regulations of the Commission, and neither the Registration Statement nor the Prospectus were to contain any untrue statement of a material fact nor omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading (R. 14-15, 20-22). The Registration Statement did not become effective until after the contract was signed (R. 390-1). The contract set February 9, 1948 as the closing date, at which date petitioner was to have delivered the stock to the underwriters, and the latter were to have paid the purchase price (R. 29-30). At the closing, the representatives of respondent and First California[1] rejected the opinion of petitioner's counsel that no material litigation was then pending, assigning as their sole reason therefor the institution of a stockholder's suit by one

[1] At the closing, Allen & Co. was willing to perform the contract despite the action of respondent and First California Company (R. 558, 830).

Masterson in a Michigan State Court on the morning of February 9, 1948 a few minutes before the time set for the closing. They thereupon refused to go ahead with the purchase of the stock (R. 422, 559, 595, 2506-9). Promptly thereafter petitioner instituted this action.

The first two causes of action were alternative. The first cause of action charged a breach of contract for respondent's failure to take and pay for the stock (R. 8-9). The second cause of action, also for breach of contract, specifically charged that respondent inspired and incited the commencement of the Masterson suit on the morning of the closing date fixed by the contract to afford it the appearance of an excuse to terminate the contract and to refuse to take and pay for the stock (R. 10-12). The third cause of action was for damages for inducing First California to breach or terminate the contract—the latter company also relying upon the pendency of the Masterson suit as the basis for refusing to perform (R. 12).

To the extent important here, respondent's answer (R. 33-35), amplified by answers to interrogatories (R. 78-80), pleaded as an affirmative defense that petitioner breached its warranty in the contract (R. 14-15) in that the Prospectus contained misleading statements respecting petitioner's earnings and trend of earnings.

The District Court decided that petitioner proved its three causes of action; that respondent had failed to prove any of its affirmative defenses and that petitioner was entitled to judgment.

Respecting the Masterson suit, the District Court stated (R. 3074):

> "That defendant procured and actually, by its agents, instituted the Masterson suit as a means to stop the

> sale of plaintiff's stock was proved beyond a reasonable doubt"

and it made detailed findings as to the manner in which respondent instigated that suit (R. 3063-7, 3074-5). The District Court also found that First California Company's only reason for refusing to perform its obligations under the contract was the filing of the Masterson suit (R. 3063). These findings were not set aside by the Court of Appeals. The case comes to this Court, therefore, with respondent's fraud in the instigation of the Masterson suit established beyond a reasonable doubt.

The District Court made detailed findings of fact with respect to the affirmative defenses and discussed them fully in its opinion (R. 3067-70, 3075-84). Respecting respondent's charge that petitioner's earnings were misrepresented, the District Court stated (R. 3081):

> "Under either the system actually used by the plaintiff or that proposed by the defendant, if that were applied consistently to all elements of costs, the summary of earnings on page 7 of the prospectus does not distort the realities."

The Court of Appeals reversed the judgment of the District Court and remanded the case with instructions to dismiss the action. It found that petitioner represented its earnings for the month of December, 1947 at $4,000,000 when, in fact, they were $900,000 (R. 3095). In so doing, it did not set aside the contrary finding of the District Court as "clearly erroneous" (See Rule 52 (a)) but merely disagreed with the District Court (R. 3097). It then held that, although respondent had knowledge of the facts, its waiver of or estoppel to assert the defense of breach of warranty arising from such knowledge was irrele-

vant because the contract was illegal and unenforceable (R. 3098). It reached this result by holding that any sale to the public by means of the then existing Prospectus would have violated the Securities Act of 1933, 15 U. S. C. §77l; by then erroneously finding that public sale of the stock could only have been made in reliance on the Prospectus in its form when the Registration Statement became effective, although in fact it could have been amended to correct any defects which might appear; and by concluding therefrom that the contract was so related to the illegal purpose of selling stock to the public under a deficient prospectus as to be itself illegal (R. 3098).[1] In doing so, it completely ignored the conflicting decision of this Court in *A. G. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38 (1941) and relied upon an erroneous proposition of law not advanced in the District Court and first obliquely suggested in respondent's reply brief in the Court of Appeals.[2]

Reasons for Granting the Writ.

1. The Court of Appeals has decided a federal question in a way which is in direct conflict with an applicable decision of this Court. Specifically, the Court of Appeals has held a contract between issuer and underwriter unenforceable under the Securities Act of 1933 and, under similar circumstances, this Court held a contract between issuer and underwriter valid and enforceable. *A. G. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38 (1941).

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[1] The Court of Appeals further held that, since there was no enforceable contract, respondent was not liable for interfering with the performance of the underwriting contract by First California (R. 3099).

[2] Petitioner sought and was denied leave to answer that brief.

2. The Court of Appeals in holding that the contract in suit was rendered illegal by the Securities Act of 1933, ascribed to that Act sanctions which it does not contain; and in which it differs from other Acts administered by the Securities and Exchange Commission: e.g. Securities Exchange Act of 1934, 15 U. S. C. §78cc; Public Utility Holding Act of 1935, 15 U. S. C. §79z; Investment Company Act of 1940, 15 U. S. C. §80a-46; Investment Advisers' Act of 1940, 15 U. S. C. §80b-15.

3. The Court of Appeals has ignored or mistaken the scope of Rule 52(a) of the Federal Rules of Civil Procedure requiring that findings of the District Court shall not be set aside unless clearly erroneous. In this connection, the Court of Appeals either totally disregarded Rule 52(a) or applied it in a manner conflicting with the applicable decisions of this Court, and in conflict with decisions of the Courts of Appeals in other circuits. In so doing, the Court of Appeals has so far departed from the accepted and usual course of proceedings as to call for an exercise of this Court's power of supervision.

4. The decision of the Court of Appeals in dealing with the standard of disclosure required in a registration statement, with principles of accountancy, with the legality of underwriting contracts, and the scope and effect of the Securities Act of 1933, vitally affects the important business of issuing and selling securities. The questions involved are of general public importance and should be considered and finally settled in the general interest.

I.

The decision of the Court of Appeals that the contract is illegal and unenforceable under the Securities Act of 1933 is in direct conflict with a decision of this Court. It also conflicts with other decisions of this Court with respect to the enforceability of contracts.

The Court of Appeals held that an underwriting contract, referring to a registration statement (including the prospectus) which failed to conform to the Securities Act of 1933, 15 U. S. C. §77a *et seq.*, was void regardless of the equities between the parties (R. 3098). In reaching this decision the court below did not cite but apparently ignored the decision of this Court in *A. G. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38 (1941), *with which its decision is in direct conflict.*

In the *Frost* case, this Court held that a contract between an underwriter and an issuer was enforceable despite the fact that the subject securities had not been registered at all under the Securities Act of 1933, 15 U. S. C. §77a, *et seq.*, in clear violation of the provisions of the Act. In so holding this Court stressed the absence of any provision in the Act that contracts in contemplation of or having relation to a public offering, not complying with the requirements of the Act, were void. 312 U. S. at page 41. This Court pointed out that Congress had provided specific sanctions in order to secure obedience to the Act and refused to create and apply an additional sanction beyond those specified in the Act, saying at page 43:

> "Courts have often added a sanction to those prescribed for an offense created by statute where the circumstances fairly indicated this would fur-

ther the essential purpose of the enactment; but we think where the contrary definitely appears—actual hindrance indeed of that purpose—no such addition is permissible."

In the absence of a clear mandate from Congress, a statutory provision is not to be construed so as to make contracts illegal and unenforceable. *Bruce's Juices, Inc.* v. *American Can Co.*, 330 U. S. 743 (1947); *Muschany* v. *United States*, 324 U. S. 49 (1945).

Clearly, the Act contains no provision making a contract between issuer and underwriter, which is valid on its face, illegal or void. The Act contains certain specific sanctions. It also excludes from the protection and benefit of these sanctions persons, such as the respondent, who had knowledge of the facts claimed to be undisclosed in the prospectus. 15 U. S. C. §§77k(a), 77l(2). The provisions of Section 14 thereof (15 U. S. C. §77n), cited by the Court of Appeals, are inapplicable, because no condition, stipulation or provision was entered into waiving compliance with any provision of the Act or of any rule or regulation of the Securities and Exchange Commission.

Section 14 of the Securities Act of 1933 is quite different in its contemplation from Section 29 of the Securities Exchange Act of 1934, 15 U. S. C. §78cc; from Section 26 of the Public Utility Holding Company Act of 1935, 15 U. S. C. §79z; from Section 47 of the Investment Company Act of 1940, 15 U. S. C. §80a-46; and from Section 215 of the Investment Advisers' Act of 1940, 15 U. S. C. §80b-15. Section 29 of the Securities Exchange Act of 1934 is typical of the others cited and reads in part as follows:

"SEC. 29. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regula-

tion thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void. . . ."

The Securities Exchange Act of 1934, 15 U. S. C. §78a, *et seq.*, was passed by Congress simultaneously with substantial amendment of the Securities Act of 1933, 15 U. S. C. §77a, *et seq.* Indeed, the Securities Exchange Act of 1934 is Title I and the amendments to the Securities Act of 1933 are Title II of the same Act. (Act of June 6, 1934, Public No. 621, 74th Cong., approved May 27, 1936). Had Congress intended contracts in contravention of the Securities Act of 1933 to be void, it would have said so with the simple specificity found in the Securities Exchange Act of 1934.

The Court of Appeals in the present case has failed to apply other important principles in respect of the enforceability of contracts.

This Court has declared that it will be presumed that a contract will be performed in such a manner as not to contravene applicable laws. *Steele* v. *Drummond*, 275 U. S. 199 (1927). Following this decision other circuits have established a principle that if a contract is susceptible of legal performance, it will be enforced. *New Amsterdam Casualty Co.* v. *Jones*, 135 F. 2d 191 (6th Cir., 1943); *Allman* v. *Winkelman*, 106 F. 2d 663 (9th Cir., 1939). The contract here in suit did not require that the stock be

resold to the public. Furthermore, as is shown *infra* p. 17, it did not require that a particular prospectus be used as part of any such resale nor did it in any way foreclose the amendment of the Prospectus if defects appeared.

Contracts will be declared void only where such a decision is calculated to further public policy. *Twin City Pipe Line Co.* v. *Harding Glass Co.*, 283 U. S. 353 (1931); *Deitrick* v. *Standard Surety & Casualty Co.*, 303 U. S. 471 (1938).

The basic policy of the Act is the protection of the investing public through the requirement of full disclosure of material facts. It is not designed to protect underwriters against issuers. No member of the investing public can be harmed by permitting such a suit as the one at bar between issuer and underwriter based on a breach of the underwriting agreement. The Act does, however, impose a duty upon an underwriter to make a reasonable investigation and makes him liable to the investing public in the event that, on the basis of such investigation, he has reasonable grounds to believe that the prospectus does not make a full disclosure. 15 U. S. C. §77k. In fact, the Securities and Exchange Commission has stated that underwriters are charged with a duty of participating in the preparation of a prospectus.[1] In the instant case, the underwriters did investigate and the Court of Appeals has found that respondent knew the facts and circumstances the presentation of which in the Prospectus the Court of Appeals found to be misleading (R. 3097-8).

[1] Note, e.g., the Commission's statement at the time of adoption of Rule 142 [exempting from the definition of an underwriter one who merely purchases an unsold portion of an issue of securities for investment] to the effect that it was adopted in recognition of the fact that owners of such secondary capital cannot practically perform "the duty of thorough investigation and analysis imposed by the Act on the underwriter proper". Sec. Act. Rel. 1862, Dec. 14, 1938.

In accordance with established practices, the underwriters in the instant case agreed to purchase the stock from the issuer presumably with a view to reselling it to the public on the basis of the prospectus contained in a Registration Statement which was to become effective subsequent to the execution of the contract. Respondent's obligation to purchase from the issuer was not contingent upon its ability to sell the stock. Delivery of the stock was to be accepted and payment made six days after execution of the contract. It was, therefore, the underwriter and not the issuer who had the primary interest in a prospectus which would make the offering to the public attractive. If the Act is so interpreted as to permit the underwriter to escape liability on the basis of facts known to him at the time the underwriting contract was signed, in the event his sale to the public is not a success, it will lessen—not strengthen—the compulsion upon the underwriter to see that the prospectus contains a full disclosure.

On the other hand, it is apparent that the question of the enforceability of underwriting contracts will not affect the care which the issuer takes in the preparation of the prospectus. The Act itself provides adequate incentives in this regard by prescribing remedies, both civil and criminal, which can be invoked against an issuer, its directors and certain of its officers. 15 U. S. C. §§77k, 77l, 77t, 77x.

The decision below leaves unsettled the rights of an innocent underwriter from whom facts were concealed by the issuer. The holding that a contract is illegal which contemplates the sale of securities under a prospectus not complying with the requirements of the Act raises doubt as to whether such an underwriter could enforce the warranties contained in the contract as well as the undertakings of the issuer to indemnify the underwriter in the event he incurs liability as a result of the failure of the prospectus to comply with the terms of the Act. Further-

more, the decision below would appear to make unenforceable those provisions of contracts which require the issuer to correct defects in the prospectus or registration statement through post-effective amendments.

Clearly, the questions presented are of primary importance in the administration of the Securities Act of 1933, 15 U. S. C. §77a, *et seq.* Indeed, they go to the heart of the mechanism for the issuance of securities in the United States through the medium of a public offering subject to the Act. If the decision of the court below is permitted to stand without reversal or modification by this Court, doubt will persist as to the rights of parties under all underwriting contracts in contemplation of a public offering of securities. Settlement by this Court of the questions presented is plainly in the public interest since they may be presented in every issue of securities within the purview of the Act by the hundreds of companies issuing securities in the United States each year.

II.

The Court of Appeals disregarded Rule 52(a) of the Federal Rules of Civil Procedure and the decisions of this Court construing it.

As a basis for its finding of fact that the earnings statement in the Prospectus was not misleading, the District Court made the following subsidiary findings:

> (a) That the earnings shown therein had been computed "in accordance with accepted accounting procedures" (R. 3068); and
>
> (b) That even if the accounting method proposed by respondent had been followed, the earnings for the month of December 1947 would have been $2,865,525 (R. 3080).

The Court of Appeals disregarded these two subsidiary findings of fact and substituted a contrary finding that the earnings of the Corporation "were rather in the neighborhood of $900,000." This finding was the basis for the further finding that the Prospectus was misleading.

If the evidence would support a conclusion either way, Rule 52(a) required that these subsidiary findings be accepted by the Court of Appeals. That rule forbids the Court of Appeals to try the issues *de novo* upon the record. *United States* v. *Yellow Cab Co.*, 338 U. S. 338 (1949); *Graver Manufacturing Company* v. *Linde Company*, 336 U. S. 271 (1949).

The record contains evidence which amply supports the findings of the District Court both as to the accounting methods followed by Kaiser-Frazer and the amount of earnings which would have been computed had respondent's proposed accounting method been followed (R. 810, 1579-80, 1725, 2542-3, 2615, Plaintiff's Exhibits 64 and 99).

There was no separate statement in the Prospectus as to the amount of December earnings. There was, however, a statement as to fourth quarter earnings, in the calculation of which December earnings of $4,009,382.53 were included. That these were the earnings for the month shown on the books of Kaiser-Frazer is apparent from the *last three* lines of the "Consolidated Statement of Income and Expense", only *two* lines of which are quoted by the Court of Appeals in its opinion (R. 3096). These three lines read as follows:

"Net Profit or (Loss) for the Month of December, 1947	$ 638,226.97
Prior Months Adjustments (see notes)	3,371,155.56
Net Profit or (Loss) for the Month of December, 1947 After Prior Months Adjustments	$4,009,382.53"

(Defendant's Exhibit 76, page denoted as "Exhibit D" R. 2276.)

This calculation of earnings was not only in accordance with the method of accounting consistently followed by Kaiser-Frazer (R. 1247-48, 1245, 1353, 2751-2, Defendant's Exhibit 31), but had been approved by the independent certified public accountants of Kaiser-Frazer (R. 810, 1366, 1610, 1631, 1635, 1638, 1730, 1739, 2542-3, Plaintiff's Exhibit 64), who had participated in the drafting of the footnote, which the Court of Appeals found to be inadequate (R. 2272). The earnings statement and footnote became part of the Registration Statement which the Securities and Exchange Commission permitted to become effective (R. 2009-10). The only evidence that earnings were not calculated in accordance with good accounting procedure was testimony by respondent's witness (R. 1307) which was so qualified on cross-examination as to render it worthless (R. 1322, 1360-63).

The figure of $900,000 used by the Court of Appeals as the profits for December is not supported by any finding of the District Court. The only reference to this figure in the record was by one witness for respondent who admitted it was not an accurate figure (R. 1322, 1360-63). The District Court found that if the accounting method proposed by *respondent*—not Kaiser-Frazer—were followed, the earnings for December would have been $2,865,525—not $900,000 as estimated by respondent's witness. This finding was supported by extensive evidence (R. 1719, *et seq.*, 1725, 1817, 2612, Plaintiff's Exhibit 98). The Court of Appeals brushes aside this finding of the District Court on the ground that the figure was not calculated in accordance with petitioner's accounting practices. Obviously it could not have been because the figure calculated in accordance with those practices was found by the District Court to be $4,009,382.53. That is the figure shown on the books of

Kaiser-Frazer as its profit for the month of December. Thus the Court of Appeals misinterpreted the findings of the District Court on this important issue of fact and misunderstood the purpose and effect of the evidence upon which the findings were based.

The District Court found that the earnings statement contained in the Prospectus was not misleading (R. 3080). The Court of Appeals did not set aside this finding as clearly erroneous as required by Rule 52(a). It merely stated that it could not agree with that finding (R. 3097). That finding is clearly a finding of fact.

The question of whether a misrepresentation has been made is a question of fact. *Devine* v. *Zimmerman*, 133 F. 2d 850 (8th Cir., 1943); *McIntosh* v. *Wiggins*, 123 F. 2d 316 (8th Cir., 1941).

Whether a prospectus is misleading depends upon the reasonable inferences to be drawn from its content. Reasonableness is a question of fact. *Wigmore Evidence* (3rd Ed., 1940) Sec. 2553; *Marlborough Corporation* v. *United States*, 172 F. 2d 787 (9th Cir., 1949).

Whether under the British Companies Act (which served as the model for the Securities Act of 1933) failure to state certain facts renders a prospectus misleading is a question of fact to be decided by the trial judge or the jury. *Broome* v. *Speak*, [1903] 1 Ch. 586; *Rex* v. *Kylsant*, [1932] 1 K. B. 442.

The evidence from which the District Court found that the earnings statement was not misleading was extensive. It included numerous documents (R. 2611-2706, 2751-3024, Plaintiff's Exhibits 97-133, Defendant's Exhibits 31-199), the testimony of the accountants (R. 1297 et seq., 1610, 1631, 1635, 1638, 1719, 1730, 1731, 1739, 1797, 1817), the fact that counsel for respondent had been advised of all the facts surrounding the calculation of the figures in the Prospectus,

had participated in the drafting of the footnote (R. 1548, 1587, 1920, 1922, 1927-9, 2269), and were prepared to give a written opinion that the Prospectus complied with the provisions of the Securities Act of 1933 (R. 473, 475-6, 528-9) and the fact that both counsel for another underwriter and Kaiser-Frazer were aware of the facts and considered the Prospectus adequate (R. 597, 817, 1927, 1931-2, 2548-50, Plaintiff's Exhibit 66).

In setting aside the finding of the District Court that the Prospectus was not misleading and drawing new inferences from the testimony and substituting a contrary finding, the Court of Appeals failed to follow the requirements of Rule 52(a). *Walling* v. *General Industries, Inc.*, 330 U. S. 545 (1946).

Respondent did not raise the issue of the illegality of the contract at the trial and the District Court did not pass upon that issue. Vital to the decision of the Court of Appeals was its statement that "the public sale of the stock by the underwriter was to be made and could only be made in reliance on that prospectus" (R. 3099). In this the Court of Appeals erred because, as we have said, the Prospectus could have been amended if any inaccuracies appeared. No finding was made by the District Court on this question, yet there was extensive evidence in the record on which a contrary finding might have been made, had the issue been raised there. This included the terms of the contract itself (R. 13-31, 303, Plaintiff's Exhibit 1), the fact that the Registration Statement had not become effective when the contract was executed (R. 390-91), the fact that the Prospectus was amended in certain respects after the contract was executed (R. 2009-10) and testimony as to discussions of amendments (R. 826, 1449, 1489).

In arriving at its decision, the Court of Appeals also stated as its fundamental premise that "the prospective purchaser of Kaiser-Frazer stock would rely heavily on the

corporation's sales and earnings during the last quarters of 1947 as the best and perhaps the only available indication of its ability to compete with the established automobile manufacturers" (R. 3092). No finding of the District Court was made to this effect and the record would not support any such finding. The Court of Appeals completely disregarded the many warnings to the prospective purchaser contained in the Prospectus (R. 307, Plaintiff's Exhibit 2) to the effect that Kaiser-Frazer had not proved its ability to compete with other automotive companies. For instance, on page 5 of that document the following statement is made:

> "The automobile business is highly competitive and is subject to sharp cyclical changes in demand. Since the Corporation began production, there has been a continued high demand for automobiles. The Corporation is unable to predict when or to what extent a decline in this demand might take place."

This Court has held that it is the function of the District Court to make findings of fact. *Kelley* v. *Everglades District*, 319 U. S. 415, 418 (1943). *Mayo* v. *Canning Co.*, 309 U. S. 310 (1940); *Hammond* v. *Schappi Bus Line*, 275 U. S. 164 (1927). The Courts of Appeals in other circuits have applied this rule so as to refuse to make findings of fact on issues not considered by the District Court. *Helbush* v. *Finkle*, 170 F. 2d 41 (9th Cir., 1948); *Campbell* v. *Campbell*, 170 F. 2d 809 (D. C. Ct. of App. 1948); *Bach* v. *Friden Calculating Machine Co.*, 148 F. 2d 407 (6th Cir., 1945); *Brown* v. *Quinlan*, 138 F. 2d 228 (7th Cir., 1943); *City of Sumter* v. *Spur Distributing Co.*, 110 F. 2d 649 (4th Cir., 1940).

The Court of Appeals' disregard of the requirements of Rule 52(a) and the decisions of this Court interpreting it is a further reason for the granting of the writ.

III.

The Court of Appeals incorrectly interpreted the requirements of the Securities Act of 1933 as to the presentation of factual data in a prospectus.

The decision of the Court of Appeals raises a question of far reaching importance as to the interpretation to be given to the Securities Act of 1933 and, more particularly, Section 12 of that Act (15 U. S. C. §77l). This Section creates certain liabilities for the sale of a security under a Prospectus which "includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading." The decision of the Court of Appeals holds in effect that, under this provision, the statement of a fact deemed by that Court necessary to make the statement of another fact not misleading is insufficient as a matter of law because it is not detailed or particularized, notwithstanding the absence of any fraud or intent to deceive.

The sole objection raised by the Court below to the Prospectus concerned the earnings statement appearing on page 7 thereof. The Court conceded that this earnings statement correctly showed earnings for each of the years covered thereby including the year 1947. The entire basis for its decision was that the figure given for the fourth quarter of 1947 in the Prospectus included adjustments applicable in part to operations for the entire year 1947 and that such fact was not sufficiently disclosed. The Court of Appeals also stated that this assumed deficiency could have been avoided by an appropriate explanatory footnote. It then considered the footnote actually employed and found that *as a matter of law* that footnote was insufficient.

That footnote reads as follows:

> "(4) The tentative information for the quarter and year ended December 31, 1947, reflects various substantial year end adjustments including provision for certain reserves and a material increase in inventories to conform to the results of the complete physical inventory taken by the Corporation as of December 31, 1947."[1]

No finding was made by the District Court that as a matter of fact such footnote was inadequate. The Court of Appeals held that such inadequacy arose as a matter of law. Clearly, the prospective investor was put on notice that "substantial adjustments", including "a material increase for inventories", had been made. Consequently, the Court said, in effect, that as a matter of law the amount of such adjustments was required to be disclosed. Thus, putting a prospective investor on notice of the existence of a fact deemed by the Court to be material is not, in the Court's opinion, sufficient as a matter of law. Such investor must have detailed information in respect of such fact.[2]

The Court did not lay down any standard as to the extent to which a fact, to which attention has been specifically called in a prospectus, must be particularized.

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[1] The above-quoted language is the footnote as it actually appeared in the Prospectus (R. 307, Plaintiff's Exhibit 2, p. 7). The last two sentences of the footnote as quoted in the Court's opinion (R. 3094) were not in the footnote.

[2] This assumes that December earnings constituted, in and of themselves, a material fact. From the accounting standpoint, such assumption would appear to be unwarranted. *Finney, Principles of Accounting, Intermediate* (1944 Ed.), p. 111. Respondent's accounting witness admitted one month's figures were ordinarily not significant (R. 1360). Yet, to be material a fact must be "likely to affect the conduct of a reasonable man." *Restatement, Law of Contracts*, Section 74.

There is nothing in the opinion of the Court of Appeals, the findings of the District Court or the record to the effect that any further particularization of the adjustments made was required by good accounting practice. (See, *supra*, pp. 13-15). Indeed, a leading accounting authority states that it would have been improper from an accounting standpoint to have shown the amount of the adjustments. *Montgomery Auditing* (7th Ed., 1949), p. 97. Therefore, the Court of Appeals has held in effect that particularization of facts of an accounting nature, deemed material, beyond that required by good accounting practice is necessary in order to comply with the provisions of the Securities Act of 1933.

There is no authority in any decision for the proposition adopted by the Court of Appeals. In *Rex* v. *Kylsant*, *supra*, p. 16, construing the British Companies Act, there was a failure to put the prospective investor on any notice of the existence of a fact. No case has held that once the investor has such notice further detailed information need be given. On the other hand, the Court of Appeals for the Sixth Circuit in *Otis & Co.* v. *Securities and Exchange Commission*, 106 F. 2d 579 (6th Cir., 1939), stated (p. 582) that the Securities Act of 1933 "did not require appellant to state every fact about the stock offered that a prospective purchaser might like to know or that might, if known, tend to influence his decision." The Securities and Exchange Commission, in its instructions, requires that "the information in the prospectus should be presented in clear, concise understandable fashion. Avoid unnecessary and irrelevant details, repetition or the use of unnecessary technical language." *General Instructions to Form S-1, Instruction D(a).*

The decision poses a serious problem to all issuers and underwriters of securities. The requirement of the Act that facts not be omitted of itself puts a heavy burden of

compliance upon the issuer and the underwriter.[1] Now the Court of Appeals has superimposed upon this requirement an additional requirement that facts, deemed material, be stated with absolute particularity. Yet, it has not established any standard by which the issuer of securities can determine whether he has met with this requirement.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN W. DAVIS,
Counsel for Petitioner,
Kaiser-Frazer Corporation.

MARK F. HUGHES,
WALSTON S. BROWN,
GEORGE EDWARD COTTER,
HELMER R. JOHNSON,
VINCENT R. FITZPATRICK,
RICHARD OWEN,
Of Counsel.

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[1] *Douglas and Bates, "The Federal Securities Act of 1933"*, 43 Yale L. J. 171, 190 (1933); *Dean, The Lawyer's Problem in the Registration of Securities*, 4 Law and Contemporary Problems 154 (1937).

Appendix "A".

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

KAISER-FRAZER CORPORATION,
Plaintiff,
against
OTIS & Co.,
Defendant.
Civ. 45-564.

Opinion.

MESSRS. WILLKIE, OWEN, FARR, GALLAGHER & WALTON,
Attorneys for Plaintiff,
15 Broad Street,
New York, N. Y.

MARK F. HUGHES, Esq.,
HELMER JOHNSON, Esq.,
VINCENT R. FITZPATRICK, Esq.,
RICHARD OWEN, Esq.,
Of Counsel.

BEN HERZBERG, Esq.,
Attorney for Defendant,
30 Broad Street,
New York, N. Y.

BEN HERZBERG, Esq.,
LAWRENCE R. ENO, Esq.,
Of Counsel.

JOHN W. CLANCY, U. S. D. J.

Findings of Fact.

1. On February 3, 1948, plaintiff, a Nevada corporation, and the defendant, a Delaware corporation, together with the First California Company, a California corporation, and Allen & Company, a partnership doing business in New York City, agreed in writing for the sale by the plaintiff to the others named of 900,000 shares of the plaintiff's capital stock at $11.50 a share. Of the stated amount of the stock, Otis & Company agreed to purchase 337,500 shares, First California Company a like amount, and Allen & Company 225,000 shares. The sale and purchase of 1,500,000 shares had originally been agreed upon but at the insistence of the defendant the reduced number was accepted by the others in the executed contract. Plaintiff further agreed to sell additional shares at $11.60 a share at their option exercised on or before February 9, 1948, to Otis & Company 225,000 shares, First California Company 225,000 shares and Allen & Company 150,000 shares or any part of such additional lots. The agreement provided that the closing under the contract would occur at ten o'clock in the morning of February 9, 1948 at the Central National Bank of Cleveland.

2. During the day of February 3, 1948 the parties were represented by their officers and in the case of the defendant also by Cyrus Eaton who with his family owned the controlling stock interest in the defendant. Together with their lawyers, these individuals were in conference and in each other's company most of the day negotiating the details of their agreement. An amendment or addition to the then printed and ready prospectus, reducing the number of shares of stock involved in the ultimate firm commitment of the parties as set forth in the prior finding and reciting a stabilization effort on that day, was prepared and approved by all present. The registration statement to which was attached as a rider a printed statement embodying this amendment or addition was approved by the Securi-

ties & Exchange Commission late in the afternoon. The stabilization effort of the plaintiff was its purchase on that day of 186,200 shares at a price of $13.50 per share on the various exchanges where the plaintiff's stock was listed. All purchases were made with the knowledge and sometimes by and sometimes in response to the prompting of Cyrus Eaton then and there present and were executed by brokers in response to orders given by Cyrus Eaton or by the plaintiff's officers in his presence and at his bidding and instruction. Indeed Eaton vetoed any suggestion of dropping the bid price.

3. Throughout the following day, February 4th, the market price of the plaintiff's stock was lower than the underwriters intended offering despite a moderate effort by defendant to stabilize during the forenoon. Late on that day Cyrus Eaton, on behalf of the defendant, conferred with the officers of the plaintiff and demanded that the defendant be relieved of its obligation under the contract as defendant was unable to perform. This was refused and Eaton predicted dire results including lawsuits. Eaton then conferred with defendant's attorney about damages in the event of the defendant's repudiation of its agreement and also about the possibility of its escape from the obligations of the contract. He was advised that issuance of a temporary injunction in an action for a permanent one would probably afford an "out" under the contract.

4. On the 5th of February, 1948, the underwriters conferred and Eaton, on behalf of the defendant, openly avowed defendant's intention to breach the contract on its part and to find an excuse for so doing if possible. He authorized the president of First California Company to convey defendant's intent to breach to the plaintiff's officers and representatives. The president of First California Company did this but at the same time advised the plaintiff's representatives that his company and Allen & Company intended to perform under the contract.

5. On February 6, 1948 a substitute for the contract involving less stock and the guarantee by two independent companies in which Henry Kaiser had an interest, of a loan necessary to finance its sale to the defendant was proposed by defendant's attorney to plaintiff's attorney and withdrawn before submission to plaintiff's officers.

6. On all of these dates, February 4, 5 and 6, a general decline in prices characterized trading in the stock market and the plaintiff's stock continued to sell at a level below the intended underwriters' offering price.

7. On February 7, 1948, Daley, president of the defendant, communicated to Henry Kaiser at Washington and to Edgar Kaiser at Willow Run a proposal that the plaintiff finance the purchase and carrying for a period of six months of a smaller quantity of the plaintiff's stock, pleading that the financial condition of the defendant did not permit its performance of its contract obligations. In making this finding we do not consider Exhibit PX 6. Both Daley and Eaton were large creditors of the defendant at the time and its resources would, to say the least, be sorely tried by performance in a declining market of its contract with plaintiff. It had negotiated only a day loan of a sum sufficient to cover the purchase price of plaintiff's stock.

8. Late on February 8 a telegram was sent by defendant to all plaintiff's directors proposing that the plaintiff's directors would purchase from the company the stock which the company had purchased during the stabilization proceeding on February 2nd.

9. On February 4th one of defendant's attorneys, at the office of the plaintiff's attorneys, had presented to him and spent some time in examining a number of the closing documents, some of which were printed, including the registration statement and the amendments and exhibits of both, the listing applications on the New York Curb Exchange, specimen stock certificates, certified copies of the articles of

plaintiff's incorporation and by-laws, and of some correspondence with the Securities & Exchange Commission. The papers thus exhibited also contained drafts of the officers' certificate, the plaintiff's attorney's opinion, and the accountant's certificate. Before that there had been forwarded to the Cleveland office of defendant's attorneys signed copies of the registration statement and its amendment and the underwriters' copies of the exhibits that had been filed therewith. The attorneys for the plaintiff and one of the attorneys for the defendant travelled to Cleveland in the same train on February 7th and the attorney for the defendant had visited the office of the plaintiff's attorneys on that day and spent some time going over the documents to be delivered at the closing.

10. On Sunday, February 8, 1948, a conference was held in the defendant's attorneys' office in Cleveland at which Daley and Eaton were present. Defendant's attorneys, Messrs. Jones, Day, Cockley & Reavis, stated that it was their position that the defendant was obligated to perform its contract on the next day. Eaton stated that the defendant was not going to take up the stock. It was arranged that on the next day defendant's attorneys were to attend the closing, examine the papers and after such examination report to Eaton and Daley for further advice.

11. In accordance with the contract, at 10 A. M., February 9th, representatives of plaintiff, First California Company and Allen and Company were present at the Central National Bank of Cleveland and prepared to perform. At 10:25 defendant's attorneys arrived unattended by their clients and without any authority to close or to pay for the stock. On that day defendant had a day loan of $3,881,250 to be secured by the stock it had agreed to purchase. Defendant's attorneys severally and successively proceeded to examine the closing papers in detail and raised a number of questions as to their accuracy and completeness. Some time prior to noon defendant's attorneys received word of the filing of a law suit against the plaintiff in Detroit by

one Masterson. After the luncheon recess this information was conveyed to the plaintiff's representatives. During the afternoon defendant's president was present at the bank for a while. After the dinner adjournment and about 9:30 in the evening the defendant, by its attorneys, formally expressed its refusal to perform under the contract and terminated it on the ground that its attorneys had given an unfavorable opinion in accordance with Section 3, Subdivision (c) of the contract. At this time the representative of First California Company also refused to perform and terminated the contract on its part. Its attorney, after a conference with the members of the Jones, Day, Cockley & Reavis firm, concurred in their unfavorable opinion. Allen & Company, through its representative, formally stated its willingness to perform. The only ground assigned by defendant's representatives and those of First California Company to support their unfavorable opinions was the pendency of the Masterson suit.

12. Before preparing and delivering the letter terminating the contract and probably before the recess for dinner, the attorneys for the defendant had demanded from and had been promised by the president of the defendant a letter stating that the defendant had no knowledge of the Masterson litigation until its attention was called to it by the press and that neither Otis & Company or anyone connected with Otis & Company had any part in promoting or sponsoring this litigation. This letter was prepared by the defendant's president that evening and read to its attorneys over the telephone at their conference before delivery of the letter of termination and actually forwarded to them so that they received it on the following day.

13. At 10 o'clock in the morning of that day plaintiff was ready, willing and able to perform and First California Company and Allen & Company were also ready, willing and able to perform. All the conditions in the contract were fulfilled on the plaintiff's part. All the required documents and instruments whose delivery depended on the plaintiff were prepared and ready for delivery and accurate.

Plaintiff had performed all the conditions of its part required. Otis & Company and First California Company, when they terminated the contract that evening, each had assigned as its sole reason for refusing to perform, the filing of the Masterson suit and the fact that it was of such a nature as was required to be reflected in the prospectus. The attorneys for defendant added this as their reason for the opinion to a letter they then gave their client which otherwise certified that plaintiff was in all respects ready and able to perform. The termination notice stated only that it was given pursuant to the last paragraph of §3 which conditions the defendant's right to terminate on plaintiff failure to fulfill the conditions stated in the contract.

14. On Thursday, February 5, Cyrus Eaton, knowing plaintiff would insist on Otis & Company's performance of its contract, had decided nevertheless that the defendant would not perform its obligations thereunder. He had been advised by the Otis & Company attorneys that the contract was binding and that the filing of a substantial lawsuit or the obtaining of an injunction on or before February 9th was the only readily forseeable event that might relieve the defendant of its obligations to the plaintiff. He had tried and failed to persuade the other underwriters to decline performance. Then he telephone Harrison, a Cleveland attorney. Both he and Harrison have testified in Court that Eaton employed Harrison to discover whether or not Kaiser-Frazer was embroiled in litigation and for other non-related service. It is found as a fact that Eaton then employed Harrison to arrange for the commencement of a stockholders' suit against Kaiser-Frazer and its directors. Harrison that same day, after Eaton's call, telephoned Martin, a lawyer at Detroit, who had some experience in prosecuting stockholders' derivative suits. Immediately upon completion of his call to Martin, Harrison reported back to Eaton in New York. Eaton left New York that evening and returned to Cleveland.

15. On the next day, Friday, Harrison was in frequent communication with Eaton and called Martin twice. He also called Pomerantz, a New York attorney, who specialized in stockholders' derivative suits and inquired of him if he was interested in filing a stockholders' suit against Kaiser-Frazer on or before February 9th. Pomerantz in effect told him he was not certain and upon completion of this call Harrison immediately called Eaton at his home.

16. At 9:30 on the morning of February 7th, Saturday, Bulkley, a Cleveland lawyer who enjoyed an annual retainer from Eaton and Otis & Company and had been in communication with Eaton, telephoned to Masterson who immediately telephoned to Martin. Neither Masterson nor Martin had known each other or heard of each other until this call. Early on the same morning Harrison telephoned to Martin and late in the morning telephoned to him again following a telephone conversation with Eaton. Pomerantz telephoned to Harrison twice on this February 7th, once in the morning and once in the afternoon and Bulkley telephoned again to Masterson late that afternoon. On Sunday, February 8th, in the early evening, Eaton telephoned to Harrison. Two hours afterwards, late on Sunday night, Harrison telephoned to Martin.

17. About half past nine on the morning of February 9th, 1948, Martin filed in the office of the Wayne County Court at Detroit, Michigan, on behalf of Masterson as a stockholder of Kaiser-Frazer Corporation, a complaint in an action seeking damages from plaintiff's directors for alleged acts and omissions and demanding as well a final injunction against the proposed sale of plaintiff's stock. No order for a temporary injunction of that character was submitted and no application for such relief made. This action was instituted as a result of a plot to establish an excuse to breach the contract conceived by Eaton, approved by Daley, and executed by Bulkley who procured Masterson as a dummy plaintiff and Harrison who supplied Martin as the attorney. What Bulkley and Harrison did was done

by them in response to directions given to them by Eaton and as Eaton's agents and what Martin and Masterson did was done by them with full understanding by each that they were operating on defendant's behalf and in performance of a common scheme participated in by all.

18. On February 9th, Hull, a member of Harrison's firm, on Harrison's instructions, was at the Wayne County Court House in Detroit when its doors were opened and inquired about the filing of a lawsuit against plaintiff and thereafter telephoned to his office at Cleveland. Before receiving this call from Hull whose first attempt to make it failed, Harrison's office misrepresenting its identity, called the Wayne County Court Clerk to inquire for a suit against plaintiff. Bulkley also telephoned to Masterson shortly thereafter and Martin, early that morning, also telephoned to Harrison, a call that was repeated shortly after noon.

19. It is further found that all of the following calls were made by the parties named at the hour and on the days stated:

February 5, 1948

Call Placed	Connection Made	Call Completed	Parties
1:00 p. m.		1:13	Eaton to Harrison
1:10 p. m.	1:16	1:29	Otis & Co. to Eaton
2:52 p. m.	3:07	3:12	Otis & Co. to Eaton
3:45 p. m.		3:47	Eaton to Otis & Co.
4:04 p. m.		4:10	Daley to Eaton
4:33 p. m.	4:40	4:42	Harrison to Martin
4:49 p. m.	5:25	5:27	Harrison to Eaton
7:55 p. m.		8:07	Eaton to Otis & Co.

February 6, 1948

1:10 p. m.	1:16	1:17	Otis & Co. to Eaton
3:37 p. m.	3:50	3:53	Harrison to Martin
6:12 p. m.	6:15	6:16	Otis & Co. to Eaton
8:14 p. m.	8:15	8:16	Harrison to Eaton
8:35 p. m.		8:44	Eaton to Harrison
8:45 p. m.	9:15	9:16	Harrison to Martin
9:40 p. m.		9:45	Eaton to Daley

Call Placed	Connection Made	Call Completed	Parties
9:45 p. m.		9:50	Eaton to Harrison
9:55 p. m.		10:00	Eaton to Daley
10:20 p. m.		10:27	Eaton to Daley
10:14 p. m.	10:25	10:32	Harrison to Pomerantz
10:33 p. m.	10:40	10:44	Harrison to Eaton
10:45 p. m.		10:47	Eaton to Daley
11:03 p. m.		11:07	Eaton to Daley
	February 7, 1948		
9:25 a. m.	9:30	9:39	Bulkley to Masterson
9:42 a. m.		9:46	Masterson to Martin
9:55 a. m.	10:00	10:05	Harrison to Martin
10:09 a. m.		10:12	Eaton to Harrison
10:57 a. m.	11:14	11:16	Harrison to Martin
11:33 a. m.		11:38	Pomerantz to Harrison
11:46 a. m.		11:47	Martin's office to Harrison
12:26 p. m.	12:30	12:33	Harrison to Martin
2:00 p. m.		2:03	Pomerantz to Harrison
2:53 p. m.	3:25	3:34	Bulkley to Masterson
	February 8, 1948		
10:00 a. m.		10:03	Eaton to Harrison
10:53 a. m.		10:54	Eaton to Daley
5:46 p. m.		5:47	Eaton's home to Harrison
8:01 p. m.	8:40	8:43	Harrison to Martin
8:52 p. m.	8:50	8:56	Harrison to Eaton
	February 9, 1948		
9:36 a. m.		9:37	Hull (Detroit) to Harrison
9:45 a. m.		9:49	Harrison to Wayne County (Michigan) Clerk's office
9:51 a. m.		9:53	Bulkley to Masterson's office
10:02 a. m.		10:03	Martin to Harrison
10:10 a. m.		10:11	Hull (Detroit) to Harrison
12:55 a. m.		12:56	Martin to Harrison

20. Everything that Cyrus Eaton did at all times involved in these findings was done by him as the authorized agent for such action of Otis & Company and was approved and confirmed by the president of Otis & Company.

21. During the year 1947 the retail sale of automobiles was conducted in a sellers' market. The plaintiff's high-

priced cars, the Manhattan and Custom models, accounted for over sixty-eight percent of the plaintiff's profits during the five month period from July 1 to November 30, 1947. The months of November, December, January and February customarily constituted the slack season in the retail car business. As of February 9th the accumulated supply of Manhattan and Custom models on the floors of plaintiff's distributors and dealers was in excess of the then current demand and had been accumulated during the preceding months since mid-September. Through October, 1947 to February 2, 1948 plaintiff projected the production of a successively lower number of Manhattan and Custom model automobiles in February, 1948. This was to be accompanied however by an increased production of Kaiser and Frazer models and an over-all increase in the number of cars to be produced so that while the percentage of the plaintiff's entire output that would consist of Custom and Manhattan cars would be less than in the closing months of 1947, the over-all production would be greater and there was no reason for plaintiff's officers and directors to anticipate either a decline in profits or a change in the financial condition of the company. There was reason to expect that the unit profit of each low-price car would increase as the production of those models increased. During December, 1947 and January, 1948 it appeared advantageous to the corporation to increase its over-all production by increasing the number of low-priced models and there is no evidence in the case that this judgment was faulty or based on any premise but its considered judgment of future business and its wisdom was actually borne out by 1948 operating results.

22. That the summary of consolidated sales and earnings for the final quarter of the year 1947, set forth on page 7 of the prospectus, was computed in accordance with accepted accounting procedures. It was tentative and unaudited as the prospectus states. After February 9th the company learned during audit that the sum of $758,000.00 debit for December advertising had been omitted. Advertising invoices were sent under the plaintiff's book-

keeping practices to its Chicago office and checked there and later audited and as audited forwarded to Willow Run on or shortly after the first day of each month. Part of this debit, aggregating more than half of the final amount was known on January 23rd to the Chicago office where its accruals were carried in a suspense account and the rest before January 31st and all that came to the knowledge of the independent auditors between February 9th and February 15, 1948. The December earnings which would be reduced by the entry of this item were never stated as such in the prospectus. The amount of this advertising charge, while considerable, is so small a fraction of a percent of the plaintiff's gross income that it is immaterial and could not have been an element in the indication of any trend of the plaintiff's sales or profits.

23. On or before February 9th the over-all financial and business condition of the plaintiff's dealer organization was good and plaintiff's relationship with its dealers had been and was satisfactory and suggested no reason to fear or expect a diminution of retail sales or over-all profits.

24. On January 28, 1948, two days after the postponement of an earlier proposed offering of plaintiff's stock, Joseph Frazer, then plaintiff's president, at an automobile dealers' meeting in Boston, told newspaper reporters that the plaintiff had no definite plans as to when the proposed new common stock would be placed on the market, that it had sufficient funds to carry out its expansion plans, and might not issue the stock at all. The whole statement made by Frazer at the time, of which this is but a part, pictured a rosy future for the automobile industry.

25. On January 29, Gilligan, the specialist in Kaiser-Frazer stock on the New York Curb, who had been selected as such specialist by the Committee in consideration, among other things, of the recommendations of both plaintiff and defendant, the latter at the prompting of the plaintiff, purchased four thousand shares of the plaintiff's stock. On

the 2nd of February, Gilligan purchased a further eight thousand shares of the plaintiff's stock in order to regulate the sales of that stock on the curb market. These purchases were made by Gilligan independently and for his own purposes. There is not a scintilla of evidence that plaintiff's officers were even aware that Gilligan purchased any stock.

26. At the time of the submission of the proposed prospectus for approval to the Securities & Exchange Commission, a rider which had been prepared was attached to the outside cover of the prospectus by the representative of the plaintiff's attorney. This attorney also had in his possession extra sheets bearing the written signature of all the officers and directors of the plaintiff. They had been executed and delivered to him by those who signed with authority to use them as action required.

27. If the 675,000 shares contracted to be purchased by defendant and First California Company were sold on February 10, 1948 they would have realized $3.00 a share so that the difference between the contract price and the amount realized would be $5,737,500.00. If the 337,500 shares for which the defendant had contracted to purchase were sold on February 10, 1948 they would have realized $5.00 a share so that the difference between the contract price and the amount realized would have been $2,193,750.00.

28. At least three weeks would necessarily have lapsed before a new underwriting syndicate could be organized and have purchased the sum of 675,000 shares and such syndicate would have paid to the plaintiff for each share the sum of $8.00. In that case the difference between the contract price and the sum realized by the plaintiff on a sale of 675,000 shares would have been $2,362,500.00. In the case of the sale of 337,500 shares the difference between the price realized by the plaintiff and the contract price would have been $1,181,250.00.

29. If the plaintiff had sold 675,000 shares over a period of ten weeks beginning February 9, 1948 it would have realized $5,173,581 and the difference between that sum realized and the contract price is $2,588,919.00. If plaintiff had sold 337,500 shares in six and a half weeks, beginning February 9, 1948, it would have realized $2,644,362.00 and the difference between that sum and the contract price would have been $1,236,888.00.

30. The plaintiff would have realized $10,260,625.00 on the firm commitment and $17,220,625.00 if the option had been taken up upon performance of the underwriting agreement. The amendment to the prospectus made it abundantly clear that a failure to sell all of the stock proposed in the contract to be sold might result in the company's inability to increase its production to the extent stated in the prospectus at page 8. It was also stated that the proceeds, if insufficient for all of the purposes set forth in the prospectus would be applied first to the acquisition and equipping of the Detroit Engine Plant and the Ironton Blast Furnace and next to the improvement of the Indianapolis Rolling Mill. It would be difficult to give this clear language the meaning of an unqualified promise such as defendant pretends to attribute to it but as matter of fact the plaintiff actually acquired the rolling mill and blast furnace and at the time the prospectus was issued had already contracted for the engine plant which was subsequently acquired.

Conclusions of Law.

1. Defendant by repudiation or termination of its contract with plaintiff breached that contract and plaintiff suffered damage thereby.

2. Defendant may not avail itself of the commencement of the Masterson suit which itself procured as an excuse for its failure to perform the contract with the plaintiff.

3. Defendant, by its action in procuring the filing of the Masterson suit procured as well its natural results one of which was that First California Company breached or terminated its contract by repudiating its agreement. *Restatement of the Law of Torts*, §766(j). Plaintiff was thereby damaged.

4. Plaintiff is entitled to judgment on all of its three causes of action in the sum of $2,588,919.00.

The first cause of action for an outright breach of its contract by the defendant has been sustained. Both Eaton and Daley testified that during the week before the day set for the closing they were resolved not to perform the defendant's contract. They never testified to any change of heart or purpose before the notice of termination was delivered to the plaintiff's attorneys. Daley once said during the Securities & Exchange Commission investigation that if the plaintiff's directors had purchased the 186,200 shares acquired by the plaintiff during the stablization operation "we would have gone through with the contract" but he promptly altered that statement to the expression of a then entertained hope that further negotiation would follow such purchase and on the trial said Otis & Company would not have taken the shares until it had checked the stories it claims to have heard. This was in answer to a question intended to expose the absurdity of his position that the plaintiff was unable to certify its financial condition. Defendant's attorneys attended at the closing and obeyed the instructions conveyed to them by Eaton and Daley during Sunday afternoon's conference to subject the documents tendered to circumspect examination and to report to their principals for further instructions. They had no authority to draft any of the defendant's funds to pay for the stock. They had no authority to close and never did have although Daley was present during the afternoon of the closing day. It stands as a stark fact therefore that the plaintiff, present in good faith and prepared in every detail for closing its contract, could not

close for want of a buyer as First California Company and Allen & Company, though ready to close could at best in their circumstances await the action of defendant.

Prompt performance of their obligations at the time fixed in the contract was in the minds of both parties. No other proof of this is necessary than the fact that the defendant and the other underwriters as well had already contracted for delivery of considerable portions of the stock involved to retail dealers. Defendant's borrowing money for a single day to cover the purchase price established the necessity of a prompt closing and its own understanding of the contract's terms. The utmost leeway that could be allowed the defendant on the evidence in the case is one hour, for testimony was uncontradicted, that a closing of this kind and size ordinarily was completed in one hour. A so-called rehearsal to which the defendant adverted occasionally during the trial was made impossible by the defendant's refusal to cooperate during the preceding week and as a matter of fact the purpose of such a rehearsal was fully served so far as this defendant goes by its attorney's scrutiny of the closing papers at the office of plaintiff's attorney which has been found.

Defendant's only answer to all this is an alleged waiver of its rights attributed to the plaintiff's delay in making a formal tender occasioned by the several critical examinations of the plaintiff's papers by the defendant's numerous attorneys. But nothing done by the plaintiff or its attorneys at the closing could have been a waiver since they were wholly ignorant of the fact that the defendant was not represented by a competent agent. *Champion Spark Plug Co.* v. *Automobile Sundries Co.*, 273 Fed. 74.

That defendant procured and actually, by its agents, instituted the Masterson suit as a means to stop the sale of plaintiff's stock was proved beyond a reasonable doubt. The timing and sequence of the calls and the conjunction and obvious corelation of calls, persons and events, each illuminating the others, unmistakably betray the conception, formulation and execution by defendant's willing tools of a plot to construct an excuse for defendant's non-per-

formance. The expositions of the calls by the participants are insufficient as warrant for their making and intrinsically incredible as narratives. Extrinsically they are contradicted by the actors themselves in numerous details, by the acceptable testimony of Pomerantz, the disinterested testimony of the Court Clerks in Detroit, the instructions Eaton and Daley gave their attorneys on Sunday and the nature and content of the complaint Martin filed. They are condemned as well by the concomitant conclusions their acceptance requires that a number of significant facts are mere coincidences. Some of the salient ones are that Eaton should retain Harrison who was completely unfamiliar with the matters involved when the defendant was being represented by a competent law firm in every way equipped to perform the services which had been asked of Harrison; that Eaton called Harrison when he did; that Harrison called Martin immediately on the same day; that Harrison telephoned Eaton a few minutes after he first called Martin; that Pomerantz was known to specialize in stockholders' derivative actions and that Martin was experienced in suits of that kind; that a few minutes after Bulkley called Masterson, Masterson called Martin whose very existence was theretofore unknown to him; that the Masterson suit was filed when it was; and the Hull happened to be going to Detroit and went directly to the Wayne County Court House when he got there. Whether or not the Masterson suit had any merits standing by itself is irrelevant. No contractor can excuse his failure to perform his contract by his own devising or effecting a breach of a condition. *Vanadium Corporation of America* v. *Fidelity & Deposit Company of Maryland*, 159 Fed. (2d) 105; *Stern* v. *Gepo Realty Corp.*, 289 N. Y. 274; *Patterson* v. *Meyerhoffer*, 204 N. Y. 96. Not only does the bringing of the action afford no excuse for the defendant's failure to perform but it is responsible in damages to the plaintiff for the failure of First California Company to perform whether its failure to perform be looked upon either as a valid termination or a breach. The action of First California was a natural and reasonably expectable consequence. *Restate-*

ment of the Law of Torts, § 766 (j). There is nothing in the testimony to shed the slightest reflection on Bronson's and Birr's avowal that the institution of the Masterson action was the sole cause of their failure to perform. For this form of damage plaintiff is liable. *Hornstein* v. *Podwitz*, 254 N. Y. 443; *General Outdoor Advertising Co.* v. *Hamilton*, 154 Misc. 871.

The agreement between the parties represented and warranted that the registration statement and the prospectus would fully comply with the provisions of the Act and the rules, regulations and instructions of the Commission and that neither registration statement nor the prospectus would contain any untrue statement of a material fact nor omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading. Defendant says that this representation and warranty was breached in the following respects: (a) That conditions attending the retail merchandising of plaintiff's Manhattan and Frazer Custom model automobiles were not sufficiently disclosed; (b) the earning summary in the prospectus gave a false impression; (c) the prospectus failed sufficiently to set forth the transaction whereby the automotive assets of Graham-Paige were acquired; and (d) there had been an adverse change in the plaintiff's financial condition subsequent to November, 1947, which was not revealed. The regulations of the Commission define a material matter as any matter "as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." *General Rules and Regulations*, Rule 405. Thus, if the company's officers were aware or had reason to be aware of an adverse trend in the sales of its cars, such as would reasonably involve a substantial decrease in its expectable profits, information of that trend would be required in the prospectus. Defendant has gone to great lengths in submitting evidence which it believes demonstrates that a bad situation for the plaintiff obtained in the retail sales of its cars and that its officers knew of the existence of that situation in the winter of 1947 and February, 1948 when the prospectus was issued.

This evidence comprises extracts from the company's records, and conclusions and projections derived therefrom, the testimony of a number of its past employees and distributors and dealers and the records and testimony of the officers and agents of finance companies whose business involved sales of its cars. Plaintiff countered with contradictory testimony of their distributors and dealers and of the finance company officials. Most of defendant's dealer witnesses and ex-employees were discredited upon cross-examination and by their own admissions and the proof derived from the records and the testimony of the agents of the finance companies became quite inconclusive when it appeared that the resources of the individual dealer was, as would be expected, the chief determinant of their business judgment in their dealings with him. The dealers who appeared for the plaintiff on the other hand were, in at least two instances, so convincing that they cast doubt on the correctness of some of the plaintiff company's own records of its orders and deliveries which were apparently headquarters' compilations of chain reports that had proceeded through a number of clerical or executive levels. It has been found that the high-priced cars constituted the source of sixty-eight percent of the plaintiff's profits over the five-month period from July 1 to November 30 and that the production schedules formulated through October, 1947 and February, 1948 and successively altered and never exactly fulfilled by actual production called for early 1948 high-priced car production, lower percentagewise to the total company product intended than had obtained in 1947. It seemed to be not unusual in the automobile industry for companies to compute production in regard to the percentage relation of their different models but for the purpose of maintaining the defendant's point, it is a deceptive calculation, since a change percentagewise in the production of high-priced and low-priced models is not a basis from which the manufacturer must or may conclude an over-all change in his prospective profits. The issue raised by the defense is not how many cars of plaintiff's models were or were intended to be manufactured and sold but whether or not

plaintiff was aware of such an unwillingness on the part of the buying public to purchase its output both high-priced and low-priced that it had reason to fear a reasonably clear indication that its automobiles were competitively salable only in numbers that would produce a recognizable diminution in its profits. There is no evidence of this kind in the case. On the contrary it appeared that for reasons sufficient to the company and whose wisdom was vindicated in the success of the lower-priced cars in the following months, their production was planned to be and was in fact increased. An increase in production results in a greater unit profit and such profit was in fact realized in 1948 by following that planned increase in low-price production. Thus it was made to appear that if the production schedule dated February 2, 1948 had actually been realized in production in that month there would have resulted almost $2,700,000 profits based on the November unit costs though they would have actually decreased.

Defendant went to considerable length in submitting evidence of the employment of compulsion upon plaintiff's dealers in order to force the sale of its Manhattan car. It was said by several witnesses that a quota system requiring the purchase of Manhattans in order to obtain delivery of the lower-priced cars was enforced. The credible evidence did not establish a company practice of imposing a quota system on its dealers as a necessary condition of their continuation in business.

There was also evidence indicating a piling up of Manhattan cars on some distributors and on the retail dealers and there undoubtedly was some piling up. Defendant stresses the seller's market that prevailed during the years involved and compares the situation of the Kaiser dealer with those engaged in merchandising the product of General Motors, Ford and Chrysler. This latter comparison is not at all impressive for it constitutes no standard of judgment of the plaintiff's then present selling market nor of its future since those manufacturers were long in the field and the very names of their automobiles are recognized as valuable trademarks so long have their owners been engaged

in establishing public confidence. Anyone who purchased Kaiser-Frazer stock knew perfectly well that he was buying into a new company attempting to enter into competition with well established and fortified manufacturers. The dealer organization in the nature of things was new. The mere fact that it was organized and operating country-wide so soon is astonishing. Inevitably it included inexperienced and financially weak members. We would take this fact to be a matter of common knowledge and part and parcel of the plaintiff's set-up, accepted by any buyer of its stock. The youth of its required service and parts supply would also be a matter of common knowledge and if either service or supply was inferior, which was not proven, that too would be an accepted feature of a new automobile manufacturer's business and would be reflected in the resale value of its cars as contrasted with the resale value in any market of long established manufacturers. The fact remains that the evidence on the trial was wholly insufficient to indicate a dissatisfied, dejected or unsuccessful sales organization such as would impose knowledge of a sales problem, present or prospective, on the plaintiff's officers. On the contrary the evidence is that the sales conditions in the months of the winter of 1947-48 were not uncommon but rather to be expected by all manufacturers, a naturally attendant circumstance of the character of the merchandise sold, with floor stocks deliberately accumulated for spring business. It is for all these reasons we have found that there was no prospect of untoward sales conditions that required revelation in the prospectus to make it honest. The prospectus truthfully described the company's sales policy and its competitive position.

Defendant complains that the plaintiff's omission, with either knowledge or deliberation, of a sum approximating $750,000.00 advertising expenses from the December adjustments constituted or contributed to making the prospectus false and misleading. The accounting proceeding set up by the plaintiff for control of its advertising business provided for an initial check at its Chicago accounting office when the bills came in. Following a later final check of

the advertising items, the month's collection was forwarded to Willow Run. Thus the advertising would be billed during January to Chicago and after audit the report would be forwarded to Willow Run in February. The defendant never asserted actual knowledge of the accrual of the advertising debit by the plaintiff's officers but insisted that they should have known it. This involves more a criticism of plaintiff's advertising accounting system and the time lag it entailed than of its officers. We regard the omission of the item as immaterial as did Hamman, the representative of the independent accountants who was questioned about it. In view of its overall insignificance as found, its omission from the preliminary unaudited accounting could not be misleading for it would certainly not reflect even in a small or auxiliary degree any trend of earnings in any event.

Defendant complains that the summary of earnings on page 7 of the prospectus was misleading in that it indirectly showed that the earnings for December, 1947 were approximately $4,000,000.00 when as a fact, upon reallocation of the yearend adjustments, the earnings were only a little over $600,000.00. We have found that the summary of earnings on page 7 was not misleading but even assuming, for the purposes of discussion, that the yearend adjustments should have been reallocated to the prior months, consistency would require a complete reallocation of all elements of costs such as advertising expenses and steel variance. In that case, as the testimony and exhibits of Hollis indicate, the earnings of December, 1947, would have approximated $2,865,525.00 and that figure makes no allowance for the six working days the plant was shut down to take the yearend inventory. The question is reduced to a choice between two different systems of accounting. Under either the system actually used by the plaintiff or that proposed by the defendant, if that were applied consistently to all elements of costs, the summary of earnings on page 7 of the prospectus does not distort the realities.

On Friday, January 30, Gilligan, the specialist, was short and on Saturday he purchased 1900 shares. He con-

tinued to buy for his own account on Monday, February 2nd, so that at the end of that day he was 1300 shares long and on February 3rd, after the opening of the market, he continued purchasing for his own account, buying at that time 4500 shares. Thereafter the plaintiff, at defendant's prompting and through the defendant's agency as we have found, purchased a total of 186,200 shares. Defendant now complains that plaintiff had deliberately rigged the market through Frazer's statement, the specialist's operations in the stock and the plaintiff's purchase of the stock. It was never contradicted that the task of a specialist handling the stock of any company on an exchange is to maintain an orderly market, and that requires his independent purchases and sales. Gilligan had made sizeable purchases and sales throughout January. Purchasing and selling stock for his own account for this purpose is part of his job. There is nothing in the case even remotely connecting the plaintiff with Gilligan's operations and there is no proof that his purchases and sales established a false price for the stock. The plaintiff's purchases as we have stated were ordered in part by Eaton in person as its agent and altogether with defendant's consent and on its advice, not to raise the price as they found it but to maintain it and that is allowed. As for Frazer's statement, it appears to us as it appeared to the Judge in *Pergament* v. *Frazer*, 93 F. Supp. 13 at pp. 34, 35, that there is nothing in the evidence to sustain a finding that he made it with an eye on the stock market. Maybe he did but there would be nothing to sustain a Judge's conclusion that he did.

The argument that the Securities Act condemns the prospectus because the amendment No. 3 was affixed after the Directors actually signed it is refuted by the language of 6(a) of the Act. 15 *U. S. C. A.* 77-F (a). Authority to complete the document was conferred on the attorney agent by delivering the blank authority sheets. None of the directors who signed have questioned the authority given by them and the plaintiff has no evidence to meet the requirement of §6(a) which puts on him the burden of showing the lapse of authority. The amendment became

effective under the ruling of the Commission and it is not for the defendant to complain about its form now.

The defendant seeks to make as one of its points the omission in the prospectus of the statement that the plaintiff's export sales had suffered a considerable falling off from October to December, 1947. This evidence, such as it was, was casually tossed into the case and never developed and we are unable to find in it anything to sustain a holding that the plaintiff was in any way at fault in the manner in which its prospectus made reference to export sales. There was also evidence that some time in 1947 Frazer made the statement as a witness in another hearing that but for the plaintiff's purchase of the Graham-Paige assets Graham-Paige was facing bankruptcy. This statement is Frazer's casual phrase to describe the poverty of Graham-Paige. Graham-Paige did possess intangible assets as the prospectus says and criticism of its language and its omissions to embody Frazer's later appraisal of its finances does not even raise an issue.

In the defendant's answer there is a further defense that the certificate given by the plaintiff's officers at the closing was ineffective and even unwarranted because it failed to reveal the alleged change in the financial condition of the plaintiff. This defense was not supported by the accountant produced by the defendant as an expert. In so far as it relies on the facts that have been discussed, it finds no support since all the questions of fact have been decided adversely to any such contention.

The defendant's eleventh defense to the first and second causes of action is without substance. It is based on these facts: That on the day of the closing, pursuant to The Uniform Sales Act, §144 (3) of the *New York Personal Property Law*, the plaintiff served upon the defendant a notice that the stock was being held by the defendant for its account until further notice and that on the 13th day of February the plaintiff served a complaint in this action pursuant to §144 (3) for the purchase price of the stock. Subsequently plaintiff's motion to amend its complaint to

present its first and second causes of action for breach of contract was granted.

Defendant contends that plaintiff's notice and subsequent service of the original complaint constituted an election of remedies. The Court, in permitting the plaintiff to amend its complaint, expressly left this question open. *Kaiser-Frazer* v. *Otis,* 8 F. R. D. 364.

So far as the defense of election of remedies has any present standing in the law, its enforcement seems based on estoppel. 5 *Corbin on Contracts,* §1220, and cases cited. There is a complete absence of any evidence in this case to indicate that the defendant had in any way changed its position to its detriment in reliance on plaintiff's notice and original complaint. Nor does it appear that the defendant so contends, but rather relies on provisions of The Uniform Sales Act. Since both Ohio and New York have enacted The Uniform Sales Act we need not consider any conflicts. We find nothing in the Sales Act nor in the cases interpreting it which sustains the defendant's position. On the contrary the Sales Act, §134 (2) of the *New York Personal Property Law* appears to expressly give the plaintiff, the unpaid seller with title, all the rights contained in §142 in addition to its other remedies. Williston on Sales, §503, p. 100. Section 142 (1) reads in part: "An unpaid seller having a right of lien • • • may rescind the transfer of title and assume the property in the goods • • • where the buyer has been in default in the payment of the price an unreasonable time • • •." Neither the Common Law, *Habeler* v. *Rogers,* 131 Fed. 43, 2nd Cir. [1904]; *Cullen* v. *Bimm,* 37 Ohio 236, nor the Uniform Sales Act supports this defense. *D'Aprile* v. *Turner, Looker Co.,* 239 N. Y. 427.

Plaintiff's damage is measured by the difference between the contract price and the value of the stock upon defendant's default. The law of damage is the law of Ohio. *Restatement, Conflict of Laws,* §413, and in *Cincinnati Finance Co.* v. *Booth,* 145 N. E. 543, the Ohio Supreme Court in 1924 held that the damage suffered by the victim

of a conversion by the non-malicious refusal of a corporation to transfer its stock on its books, was determined by the market value of the stock at the time the cause of action accrued. The Court rejected the average of sales over a reasonable period as a norm of market value. We have no other Ohio case and no Ohio authority has been furnished by counsel. That case involved sixty shares worth $12.00 each and the wrong was of a technical character. We find it hard to believe that the Ohio Courts would impose such a rule of damage on the plaintiff in this case where a block of stock of unexampled size was the subject matter of the contract. On this issue we found Gilligan a convincing witness and believe that he spoke with authority and knowledge and accept his testimony that the readiest market for the plaintiff's stock on February 9th or 10th would have been a hastily gathered coterie of brokers who would anticipate the necessarily long time for disposing of their purchase and would rate the price accordingly. But to accept this as the market would have the appearance of inflicting special damages which the plaintiff has disclaimed however specious that appearance might be. We were favored on the trial by the testimony of a credible and competent expert who gave the value of the stock on the 9th day of February, 1948, not on the theory that it was actually sold on that day but on the theory that its ratable disposition for a reasonable time thereafter which he fixed at ten weeks would establish the market value for a willing purchaser on that day. The witness derived his conclusion of a reasonable time largely upon the considerations expressed by our Circuit Court in *Groff* v. *Mumford*, 150 Fed. (2d) 825, at 827, and while any period adopted as reasonable is to some extent arbitrary, whatever the norm for its composer's judgment, we believe Dr. Badger's conclusion of a ten week period acceptable and adopt it. To extend the time for further disposal as another of his calculations suggested would require plaintiff to assume for a longer period the continuing risk of a declining market and the utter failure for three weeks after default to realize anything. The plaintiff has submitted through his two wit-

nesses sufficient bases for determining its damage and all of them, with the exception of the actual sale of the entire quantity on the 9th, are highly favorable to the defendant who as a wrongdoer would certainly find no just reason for complaint whatever one was adopted. In fact defendant has been indulged by each of Dr. Badger's calculations even though the plaintiff's cause of action for the immediate offense to it is for only a breach of contract. *Story Parchment Company* v. *Paterson Co.*, 282 U. S. 555, at 563. On this basis it has been found that the damages suffered by the plaintiff on the second and third causes of action were $2,588,919.00. That would include the damage on the first cause of action which would in any event be the same as the damage on the second cause of action as an award has been made on the third.

JOHN W. CLANCY,
United States District Judge.

Dated: New York, N. Y.,
July 2nd, 1951.

DARK PAGE BLEED THRU

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CHARLES ELMORE CROPLEY
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 123.

KAISER-FRAZER CORPORATION, *Petitioner*,

v.

OTIS & CO., *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF RESPONDENT IN OPPOSITION

ABE FORTAS,
MILTON V. FREEMAN,
Attorneys for Respondent.

BEN HERZBERG,
LAWRENCE R. ENO,
ARNOLD, FORTAS & PORTER,
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

	Page
Opinion Below	1
Jurisdictional Statement	1
Statute Involved	2
Questions Presented by the Petition	2
Statement	2
Argument	9
Construction of the Securities Act	9
Rule 52(a)	10
Enforceability of the Contract	11
Conclusion	18

CITATIONS.

CASES

The Bank of United States v. *Owens*, 2 Pet. 527..... 14
Continental W. P. Co. v. *Louis Voight & Sons Co.*, 212 U.S. 227 14
Dent v. *Ferguson*, 132 U.S. 50 12
Fox v. *Gardner*, 21 Wall. 475 12
A. C. Frost & Co. v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 .....12, 13, 14, 15
Jackson v. *Bryant*, 33 Ohio App. 468, 169 N.E. 825 (1929) 12
Judson v. *Buckley*, 130 F. 2d 174 (CA 2, 1942) cert. den. Buckley v. Judson, 317 U.S. 679.....13, 14, 15
Materne v. *Horwitz*, 101 N.Y. 469, 5 N.E. 331 (1886) 12
Randall v. *Howard*, 2 Black 585 12
Reiner v. *North American Newspaper Alliance*, 259 N.Y. 250, 181 N.E. 561 (1932) 12
Rex v. *Kylsant* (1932) 1 K.B. 442 13

STATUTES Page

Rule 52(a), Federal Rules of Civil Procedure....1, 2, 10
Mail Fraud Statute, 18 U.S.C. § 1341 13
Securities Act of 1933, 15 U.S.C. § 77a, et seq..... 2
Sec. 6a, 15 U.S.C. § 77 f (a) 17
Sec. 11, 15 U.S.C. § 77 k 17
Sec. 11(b)(3), 15 U.S.C. § 77 k (b) (3) 17
Sec. 11(f), 15 U.S.C. § 77 k (f) 17
Sec. 14, 15 U.S.C. § 77 n 12
Sec. 17, 15 U.S.C. § 77 q 17
Sec. 17(a), 15 U.S.C. § 77 q (a) 13
Sec. 24, 15 U.S.C. § 77 x 17

Securities Exchange Act of 1934, 15 U.S.C. § 78
Sec. 9(a)(4), 15 U.S.C. § 78 i (a) (4)..... 13
Sec. 29(b), 15 U.S.C. § 78 cc (b) 14, 15
Rule X-10B-5 .....13, 15

MISCELLANEOUS

Loss, Securities Regulation, pages 811, 824, 832..... 15
Restatement of Contracts
Section 577 . . ..12, 13
Section 598 . . ..12, 13
Section 599 14
6 Williston, Contracts (Rev'd 1938) Section 1738..12, 13

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BRIEF OF RESPONDENT IN OPPOSITION

OPINION BELOW

The findings and opinion of the District Court are set forth in the Record at pages 3089-3099. The opinion of the Court of Appeals by A. N. Hand, Circuit Judge, with Clark, Circuit Judge, and Brennan, District Judge, concurring, is reported in 195 F. 2d 838.

JURISDICTIONAL STATEMENT

The order of the Court of Appeals was entered on April 7, 1952 (R. 3099-3100). The petition for a writ of certiorari was filed on June 12, 1952. The jurisdiction of this Court is invoked under 28 USC § 1254 (1).

STATUTE INVOLVED

The statute involved is the Securities Act of 1933, 15 USC § 77a, et seq., particularly sections 11, 12, 14 and 17 of that Act.

QUESTIONS PRESENTED BY THE PETITION

1. In the circumstances of this case, was the failure to disclose that earnings for the last month and quarter shown in the registration statement and prospectus had been inflated by $3,100,000 a violation of the Securities Act of 1933 and of the warranty of the contract?

2. Did the Court of Appeals contravene the requirements of Rule 52(a) of the Federal Rules of Civil Procedure?

3. Where the issuer had filed and furnished to the underwriter a false and misleading prospectus for use in the sales of shares to the public, may the issuer nevertheless recover damages against the underwriter for refusal to purchase the shares for resale to the public?

STATEMENT

Kaiser-Frazer Corporation was organized in 1945 to engage in the manufacture and sale of automobiles. It was financed by the sale to the public of two issues of stock. The first issue, in late 1945, was sold to the public at $10.00 a share; the second, in early 1946, at $20.25 a share. The company realized about $50,000,000 from these two issues. The company has paid no dividends since its organization (PX 2, p. 3, p. 29; R. 1385).[1]

The present controversy relates to a proposed third public offering of stock in February 1948.

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[1] References to pages of the printed record will be made as "R. ." The prospectus of the offering in question was not printed in the record below but handed up to the court. A similar procedure is being followed with respect to this petition. The prospectus was introduced at the trial as Plaintiff's Exhibit 2 and is referred to here as "PX2". The Petition for Certiorari is referred to as "Pet. p. —".

The company began the actual production of automobiles in 1946 (PX 2, p. 3). These were two medium priced models called the Kaiser and the Frazer (R. 2756, 2349). For that year, 1946, the company showed a net loss in excess of $19,000,000 (PX 2, p. 7). During the first quarter of 1947, ending March 31, the company's losses continued, amounting to more than $3,000,000 (id.).

In May of 1947, officials of the company approached representatives of Otis & Co., which had headed the underwriting groups in the previous public offerings, to discuss the possibility of selling additional securities to the public. The Otis representatives advised the Kaiser-Frazer officials that a public offering was out of the question until the company showed substantial earnings (R. 1386-87, 2012-13).

During the latter part of 1947, Kaiser-Frazer officials resumed discussions with Otis as to a third public offering of securities (R. 1388-89). These discussions culminated in the underwriting contract which is the basis of this litigation. This contract was signed on February 3, 1948. Under its terms and subject to its conditions, Otis & Co., First California Company and Allen & Co., severally agreed to purchase an aggregate of 900,000 shares of Kaiser-Frazer's common stock for resale to the public at $13 per share (R. 13-31).

A registration statement had been previously filed by Kaiser-Frazer, and the prospectus which was part of the registration statement had been distributed to the public (R. 1392-94, 2825-32). The registration statement became effective on February 3, 1948, immediately after the underwriting contract was signed (R. 326-27), and the stock was actually offered to the public on February 3 and 4, 1948 (R. 2554-55). However, the underwriters terminated the offering on the latter date (R. 575-77). On the date set for closing, February 9, 1948, Otis and First California formally advised Kaiser-Frazer that they were terminating the contract and would not accept delivery of any shares covered

by the registration statement (R. 2710).[2] No shares of the issue were sold and delivered to the public.[3]

Kaiser-Frazer then brought the present action against Otis for damages for breach of its contract and for inducing breach by First California (R. 1-3). Otis' defense to this action was based primarily upon the grounds (1) that Kaiser-Frazer had made false and misleading statements to the underwriters and the public in the registration statement and prospectus which constituted a breach of warranty and a breach of condition precedent under the contract[4] and a violation of the Securities Act; and (2) that the pendency of material litigation, filed prior to the time for closing, also relieved the underwriters of any obligation to purchase the shares (R. 32-49).

The District Court, Clancy, J., sitting without a jury, decided all of the issues in favor of Kaiser-Frazer (R. 3057-3086). On appeal, the Court of Appeals unanimously reversed (Augustus N. Hand and Clark, Circuit Judges, and Brennan, District Judge (R. 3089-99)). The Court of Appeals, in an opinion by Judge Hand, decided that the registration statement and prospectus misrepresented Kaiser-Frazer's profit for the month of December and the last quarter of 1947; that this constituted a breach of warranty and a violation of the Act; and that accordingly Otis had a complete defense to the complaint (R. 3091). It, therefore, did not discuss the other errors in the judgment of the District Court presented by Otis on the appeal (R. 3091).

The relevant facts may be briefly summarized as follows: In early 1947, Kaiser-Frazer was faced with the fact, of

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[2] Allen & Co. likewise did not take or pay for any shares (R. 517-20).

[3] This action saved the public millions of dollars. The total price of the issue to the public was about $10,000,000. The shares thereafter declined in value. Their market price on the New York Curb Exchange dropped sharply from $13 per share (R. 2585-88) and went as low as 2⅞ (R. 1931). Their present market value on the Curb Exchange is between $4 and $5 per share.

[4] The underwriting contract provided that Kaiser-Frazer warranted as a condition of the underwriters' liability that "When the Registration Statement becomes effective, the Registration Statement and the Prospectus will fully comply with the provisions of the Act, and the rules and regulations and instructions of the Commission thereunder; and neither the Registration Statement not the Prospectus will contain any untrue statement of a material fact nor omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading; . . ." (R. 14-15, 20; § 1 (c) and 3).

which it was advised by Otis, that it could not fulfill the desire of its top officials to sell additional securities to the public unless it could show an impressive record of profitable operations (R. 1386-87, 2012-13).

The year 1947 was a boom period for the automobile industry as a whole. There was great demand for automobiles due to their relative unavailability during the war, and it was possible to sell automobiles in large quantities at very high prices (R. 2291, P X 2, p. 5). Kaiser-Frazer determined to attempt to capitalize on this situation. At the time of its organization, the company had been widely represented as intending to produce low-priced automobiles (R. 2348-49). It had not done so. Its Kaisers and Frazers were in the medium price class (R. 2349), but despite this fact, the company had lost money on every one of them that it had produced. In these circumstances, in the early months of 1947, the company decided to turn out a new "model", to be sold at high prices and to yield a high profit, and to sell as many of these to its dealers as they could be induced to take. These automobiles were priced in the lower Cadillac price range (R. 2756, 2921), but they were exactly the same car as the cheaper Kaiser or Frazer, except for upholstery and trim (R. 1337, 1951).

In the initial month of volume production of these high-priced and high profit "models", May 1947, the company was able to show a profit for the first time in its history (R. 2751). Thereafter, for a few months until November 1947, the company's profits showed a spectacular increase (R. 2751). These boom earnings, however, were due primarily to the sales of the high-priced models. During the five months' period of 1947 from August 1 to December 31, at least 68% of Kaiser-Frazer's profits on automobiles were due to the sales of these models (R. 2760).

From the time that it resumed negotiations with Otis & Co. in the latter months of 1947, until the contract was signed on February 3, 1948, the company consistently represented to Otis and the other underwriters that the volume of sales of these models was continuing and that it had no

reason to anticipate a decline (R. 1509-11, 1515, 1603, 1502). This was contrary to the fact. Well before the registration statement became effective, the company knew that it had come to the end of the road on the profitable operation of selling high-priced cars. Beginning in the middle of October 1947, at the urgent insistence of its Sales Department (R. 2809-10, 2812), the company began drastic cutbacks in its production of these models. The result was that such production dropped from over 50% of total output in early October (R. 2777) to less than 20% by the time the registration statement became effective (R. 2754, 2760); sales of these models to dealers dropped from 9,176 in October 1947 to 3,217 in January 1948 (R. 2754); and projected production of these models for the five months after the proposed offering was about 16% of total production (R. 2766-67). There is no claim and no evidence that Otis knew these facts.

These facts were also concealed from and misrepresented to the public in the registration statement and prospectus which were finally amended on February 3, 1948 and became effective on that date. In its registration statement and prospectus the company did not disclose that 68% of the company's profits were derived from the sale of the high-priced models, and it misrepresented and concealed the fact that the demand for these models had drastically declined and that the company had already reflected such decline in its internal operations.[5]

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[5] The prospectus stated (PX 2, p. 5):

> "Both the Kaiser Custom and the Frazer Manhattan [the high-profit models] are in the high priced automobile field . . . . The public has since the inception of production by the Corporation and is at the present time purchasing high-priced automobiles in numbers much greater than was the case prior to the last war. *The Corporation is, of course, not in any position to predict how long this condition will continue.*" (emphasis supplied)

Of course, the company was not only in a position to "predict" but had "predicted for purposes of its own operations that its sales of high-priced cars would decline. They had already declined and the company had cut production accordingly (see text).

Before the Court of Appeals Otis urged that the concealment and misrepresentation described was a breach of warranty providing Otis with a complete defense to the action. The Court of Appeals found it unnecessary to rule on this (R. 3091).

This adverse turn in the company's fortunes had full impact upon the company's earnings for December 1947. In that month the company's net profits declined from an average of about $4,700,000 in each of the two preceding months [6] to only $638,226.97 as shown by the company's own operating report for December 1947 (R. 3096).

If Kaiser-Frazer had used the net profit figure of $638,226.97 for December in the registration statement and prospectus, the securities could not have been sold (R. 2127-28). Accordingly, the company used instead a "net profit" figure for December of $4,009,382.53. It arrived at this sum by the simple process of adding to its December net profits, as shown by its own accounts, the figure of $3,371,155.56. This figure was carried on its books as "*Prior* Months' Adjustments" (R. 3096).[7] It reflected principally the results of inventory writeups. These write-ups were not allocable to the month of December or the last quarter of 1947, but to the entire year's operations and to prior years (R. 3095, 3096). There is no testimony in the record which even attempts to justify this procedure on the basis of permissible accounting principles.[8]

The Court of Appeals held that this constituted a material misrepresentation of fact which violated the Securities Act of 1933 and constituted a breach of Kaiser-Frazer's warranty to the underwriters. The court pointed out that,

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[6] The registration statement showed only a combined figure for October and November net profit of $9,406,000. Actually this figure was misleading. November earnings had already declined showing that the company's short-lived boom was at an end. November earnings were approximately $2,000,000 below October (R. 2751).

[7] The company's "Consolidated Statement of Income and Expense" for December 1947, prepared for its own use, showed the results of the month's operations as follows (R. 3096):

"Net Profit or (Loss) for the Month of December, 1947	$ 638,226.97
Prior Months' Adjustments (see notes)	3,371,155.56"

The total of these two figures, $4,009,382.53, to the penny, was used as December "net profits" for purposes of the registration statement and prospectus (PX2 p. 7).

[8] The figures were not certified by independent auditors but were provided on the company's own responsibility (R. 3093).

as the company's own books showed, its December earnings were nowhere near the $4,009,000 shown in the registration statement and prospectus, but were rather "in the neighborhood of $900,000";[9] that the corporation knew on February 3, 1948 when the registration statement became effective that its profits for December were less than $1,000,000; that its misrepresentation of these profits by the simple process of adding "Prior Months' Adjustments" to actual December profits, could not be justified on accepted accounting procedures; and that this misrepresentation, particularly in view of the brief period of the company's earning history and the speculative nature of the enterprise, was material and misleading (R. 3095-97).

According to the court, the company's representation of its December earnings "was $3,100,000 short of the truth" (R. 3097).

The court also held that the footnote that appeared in the prospectus relating to the earnings for the last quarter of 1947 was "entirely insufficient" to disclose the nature and source of the "net profit" figures as shown in the prospectus. As the court stated, "No one reading [the footnote] would have been put on notice that the actual profit for December was less than a fourth of what was indicated by the table [of earnings]."[10] (R. 3097)

The court then proceeded to discuss Kaiser-Frazer's contention that Otis had "full knowledge" of the facts as to the December earnings prior to the time it entered into the contract, and could not now rely on these facts as a defense. Neither the Court of Appeals nor the District Court

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[9] This figure was composed of the $638,000 earnings and approximately $260,000 of the inventory adjustment which properly belonged in December and not to prior months (R. 3096 and note).

[10] The footnote merely stated:

> "The tentative information for the quarter and year ended December 31, 1947, reflects various substantial year end adjustments including provision for certain reserves and a material increase in inventories to conform to the results of a complete physical inventory taken by the Corporation as of December 31, 1947." (PX2, p. 7)

found that Otis had such knowledge,[11] but the Court of Appeals held that even if Otis had knowledge of the facts, under familiar principles of law, relief could not be granted to Kaiser-Frazer because the performance of the contract would have involved a fraud on the public and would contravene provisions of law and public policy (R. 3098-99).

ARGUMENT

The decision of the Court of Appeals does not present any novel or important question of legal principle warranting review by this Court. It involves merely the application of settled principle to the facts of this case. It is an action on a contract which is in the federal courts only because of diversity of citizenship.[12] It involves no substantial question of construction of any federal law. It does not conflict with any decision of this Court, and the decision of the Court of Appeals is plainly correct. Accordingly, no ground for review by this Court exists.

Construction of the Securities Act. The contract contained a specific warranty that Kaiser-Frazer would prepare and file a registration statement and a prospectus to be used in the public offering of the securities, and that when the filing became effective (R. 14, § 1(c)), these documents would comply with the requirements of law and would contain no misrepresentations or material non-disclosures (R. 14, 15, Section 1(c), see *supra*, p. 4, footnote 4). Com-

[11] The record shows that Otis did not have knowledge of the essential facts but was affirmatively misled. When Otis' representative, Kissell of Jones, Day, Cockley & Reavis received an intimation as to adverse December figures, top executives of the Company flew to New York to assure him the information was wrong. He was told various stories including the false statement that December advertising had through oversight been charged twice. (R. 1531-32, 1932, 1941-42, 1928-29). The figures for the last quarter and year 1947, and the footnote on page 7 of the prospectus, were added in the absence of any representative of Otis and underlying figures were never supplied to Otis (R. 1532-33, 1647, 1500). The contrary statement at p. 17 of the petition is flatly unsupported by the record. Otis also offered to prove that Kissell was told that the entire summary had been cleared with the Securities and Exchange Commission, which was false (R. 1540-41, 1561-63, 1616-19).

[12] The action was in fact originally brought in the Supreme Court of the State of New York and removed because of diversity of citizenship (R. 1, 3).

pliance with this warranty was expressly made a condition of the underwriters' obligation (R. 20, § 3). Kaiser-Frazer breached the warranty by filing and furnishing to the underwriters a registration statement and prospectus which misrepresented earnings for December and the last quarter of 1947. There can be no doubt that these earnings were grossly misrepresented, and that the misrepresentation was material. This adequately appears from the opinion of the court below and from the Statement in this brief, and we shall not elaborate the point. The argument of the petition (p. 19) that the Court of Appeals erred in its application of the Securities Act and in holding that there was a material misrepresentation of fact is entirely without merit.

Rule 52(a). Kaiser-Frazer nevertheless urges (Pet. p. 13) that this Court should review the decision of the Court of Appeals because that court "disregarded" Rule 52(a) by rejecting various "findings" of the District Court (Clancy, J., sitting without a jury). Kaiser-Frazer urges that the District Judge "found" that the earnings statement in the prospectus was not misleading; that the Court of Appeals "merely stated that it could not agree with that finding", but did not expressly characterize the finding as "clearly erroneous" as required by Rule 52(a) (Pet., p. 16). There is no merit in that contention.

The facts relating to December and last quarter earnings, 1947, were not in dispute. They were taken entirely from the company's own books and records (R. 1247-48). The only question was whether it was a misrepresentation for Kaiser-Frazer to add to "net profits" for December and the last quarter of 1947 the sum of several millions of dollars representing inventory writeups and other "adjustments" attributable to operations for the entire year and prior years. There is no question that the addition was made. The only issue was whether it constituted a material misrepresentation. The Court of Appeals concluded

that the represented earnings were "$3,100,000 short of the truth." (R. 3097) The Court of Appeals was entirely and obviously correct.[13]

Enforceability of the Contract. Kaiser-Frazer's final point is that the Court of Appeals erred in holding that, even if Otis had known the facts as to December and last quarter earnings, the contract between the parties was unenforceable (Pet., p. 5). Neither the Court of Appeals nor the District Court found that Otis had "full knowledge of all the facts" as Kaiser-Frazer contended. The District Court made no finding as to knowledge. The Court of Appeals stated only that "there is some support" for the view that Otis was informed of December earnings, but it regarded the point as unimportant in the context of the case because even if Otis had full knowledge, the contract would be unenforceable. The court pointed out that this is not a case of an ordinary contract of purchase and sale between two parties, but a case in which the interest of others than the parties to the contract is involved and in which performance of the contract as contemplated by the parties by public sale of the shares would defraud the public and be contrary to law and public policy. ". . . whatever the rules of estoppel or waiver may be in the case of an ordinary contract of sale," the court held, it is clear that a contract will not be enforced even if full knowledge of the facts by the contracting parties is assumed, where the performance of the contract would be a

[13] Kaiser-Frazer did not question the fact, and indeed did not even put an accountant on the stand to rebut Otis' accounting testimony that the addition of "Prior Months' Adjustments" to December earnings violated accepted accounting practice (R. 1307, et seq.). Its only answer was in the nature of confession and avoidance. It presented testimony of one of its staff accountants who sought to show that by disregarding Kaiser-Frazer's established method of accounting, December earnings could have been padded by other means so they would be only $1,200,000 less than represented (R. 1718-23, 1799-1800). The Court of Appeals rejected this approach on the ground that December figures must be shown on a basis consistent with prior figures in the same table of earnings (R. 3096). Even assuming that this approach were permissible, December and last quarter earnings would nevertheless have been materially misrepresented by $1,200,000.

fraud upon the public, contrary to public policy, and a violation of law (R. 3098-99).[14]

In so holding, the court applied the familiar principle of law that a bargain, performance of which would tend to harm the public by deceiving it as to material facts and which would also contravene provisions of law and public policy, is illegal and unenforceable. RESTATEMENT OF CONTRACTS, §§ 577, 598; 6 WILLISTON, CONTRACTS (Rev'd 1938) § 1738, and particularly text and cases cited at p. 4912, n. 15, p. 4913, n. 17 and p. 4914, n. 21; *Randall* v. *Howard*, 2 Black 585, 588; *Dent* v. *Ferguson*, 132 U. S. 50, 64; *Fox* v. *Gardner*, 21 Wall. 475, 480; *Materne* v. *Horwitz*, 101 N. Y. 469, 5 N. E. 331 (1886); *Reiner* v. *North American Newspaper Alliance*, 259 N. Y. 250, 181 N. E. 561 (1932); *Jackson* v. *Bryant*, 33 Ohio App. 468, 169 N. E. 825 (1929).[15]

Kaiser-Frazer argues (Pet. p. 8) that this part of the court's decision is in conflict with the decision of this Court in *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38. That is not true. The *Frost* case and the present case differ not in the legal principles involved, but in the facts to which they were applied. The familiar doctrine of unenforceability, which was applied by the court below, is plainly reiterated in the *Frost* case. That case repeats the "rule that contracts in contravention of public policy are not enforceable", and defines the basis of the doctrine in these terms: "No one can lawfully do that which tends to injure the public or is detrimental to the public good" (312 U. S. at 44).

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[14] The court further pointed out that Section 14 of the Securities Act would support the view that even if Otis had knowledge of the facts, it would not be estopped to assert as a defense the fact that Kaiser-Frazer had filed a false and misleading registration statement in violation of law. Section 14 provides that any stipulation or provision to waive any requirement of the Act is void (Opinion, footnote, R. 3098). It should also be noted that the contract in this case provides that any investigation made by the underwriter shall not operate to relieve the issuer of its full responsibilities under its warranties, including its warranty that the registration statement and prospectus, when they become effective, will be complete and accurate (R. 25 § 4 (a)).

[15] The citation of State cases is here limited to New York and Ohio, since the contract was made in New York and closing was scheduled in Ohio. Other states are in accord. See texts cited.

The *Frost* case involved nothing more than an "absence of registration" under the Securities Act (312 U. S. at 41). It did not involve an attempted fraud on the public or any element of deceit or misrepresentation. In *Frost* this Court held that the mere failure to register, without more, did not render a contract of purchase and sale unenforceable between the parties. The Court emphasized that "the challenged contract bears no evidence of criminality and is fair upon its face" (*id.* at 42). That, of course, is not the situation in the present case, which involves gross misrepresentations of earnings designed to defraud the public and to induce it to purchase $10,000,000 of securities in violation of criminal and civil statutes [16] and common law principles designed to prevent and punish frauds on the public.[17]

In the *Frost* case this Court referred to the "protean basis" of the doctrine of unenforceability and clearly recognized that its application to cases involving the Securities Act must necessarily be determined by the facts of each case (312 U. S. at 44). The essentially *ad hoc* nature of the doctrine applied in the *Frost* case is illuminated by the decision of the Court of Appeals for the Second Circuit, which also decided the present case, in *Judson* v. *Buckley*, 130 F. 2d 174 (CA 2, 1942), cert. den. *Buckley* v. *Judson*, 317 U. S. 679. Two of the judges who decided the present case also participated in *Judson* (A. N. Hand and Clark, C. J.), and the opinion in both cases was written by Judge Hand.[18] The *Judson* case involved a misrepre-

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[16] Section 17 (a) of the Securities Act of 1933 (15 U.S.C. § 77 q (a); Rule X-10B-5 under the Securities Exchange Act of 1934; Section 9(a) (4) of the Securities Exchange Act of 1934 (15 U.S.C. § 78 i (a) (4); and the Mail Fraud Statute (18 U.S.C. § 1341) are among the prohibitions which would be offended by sale of the stock to the public by the false prospectus. See also, p. 15 *infra*.

[17] See RESTATEMENT OF CONTRACTS; WILLISTON ON CONTRACTS, both *loc. cit. supra*; *Rex* v. *Kylsant* [1932] 1 K. B. 442.

[18] The Securities and Exchange Commission, which in the *Frost* case had filed a memorandum attacking the suggestion that all contracts for the purchase of securities should be held unenforceable because of the absence of registration, filed a brief in *Judson* urging that the Court refuse enforcement because *Judson* involved an affirmative misrepresentation rather than an absence of registration. See 130 F. (2d) at 180, see also footnote 21, *infra* p. 15.

sentation in the registration statement of the ownership of the securities offered for sale. Primarily because the misrepresentation could not "mislead prospective purchasers as to the value of the stock or really prejudice them in any way" and the "public offense" committed was therefore "one of little practical significance" (130 F. 2d at 179), the Court of Appeals granted enforcement of the contract as between the parties.[18a]

This contract (unlike the agreement to sell without registration in the *Frost* case) would have been unenforceable before the Securities Act of 1933 was enacted. See authorities p. 12, *supra*. It belies the spirit and history of that statute to suggest that it was designed, by implication or otherwise, to legitimize or make enforceable for the first time such agreements to defraud investors.

Kaiser-Frazer argues (Pet. pp. 9, 10) that the doctrine of unenforceability cannot be applied by the courts in any case involving the Securities Act because that Act does not contain a provision like Section 29(b) of the Securities Exchange Act of 1934, which expressly makes void contracts the performance of which would violate the provisions of the Act, or the rules and regulations thereunder (Sec. 29 (b), 15 U. S. C. § 78 cc (b)). As the *Frost* case recognizes, the absence of express statutory provision is, of course, not determinative. The decision below rests on general principles of law which establish the power and duty of the courts as a matter of statutory law to refuse enforcement of contracts in appropriate circumstances.[19]

In any event, by Kaiser-Frazer's own argument, the fact that the Securities Exchange Act expressly makes contracts in violation of its rules void (Sec. 29 (b)) outlaws the present contract. For the performance of this contract

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[18a] Kaiser-Frazer expresses concern for the effect of the holding below on innocent underwriters (Pet. pp. 12, 13.). The basis of the doctrine of unenforceability of course the courts requires to protect an innocent underwriter in his rights under the contract while denying relief to the guilty issuer. RESTATEMENT OF CONTRACTS § 599.

[19] See *The Bank of United States* v. *Owens*, 2 Pet. 527; *Continental W. P. Co.* v. *Louis Voight & Sons Co.*, 212 U. S. 227.

would violate the provisions of Rule X-10B-5 issued under the Securities Exchange Act of 1934[20] as well as the similar provisions of the Securities Act of 1933.

Finally, Kaiser-Frazer argues (Pet. p. 11) that to refuse enforcement of the issuer's claim against the underwriter here would hinder the purposes of the Securities Act. In this connection it relies upon the Court's statement in the *Frost* case that to refuse to permit an underwriter to recover against an issuer merely because of the failure to register the securities might result in "actual hindrance" of the purpose of the Act.[21] We do not challenge the point that there may be instances in which the refusal of enforcement would hinder the achievement of the purposes of the Securities Act. However, we believe that in a case such as is here presented, involving an entirely unexecuted contract and an attempt to defraud the public, it is clear that the refusal of enforcement will materially advance achievement of the purposes of the Act. This case involves an

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[20] Rule X-10B-5 reads as follows: "*Employment of Manipulative and Deceptive Devices*—It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

The substantial identity of the provisions against false statements contained in the Securities Act and the Securities Exchange Act are discussed in Loss, Securities Regulation, pp. 811, 824, 832.

Section 29(b) of the Securities Exchange Act of 1934 renders "void" contracts performance of which involve a violation of "any provisions of this title or of any *rule or regulation* thereunder". (Emphasis supplied)

[21] Justice McReynolds, writing for the Court, did not elaborate on this point, but merely referred to a memorandum filed by the Securities and Exchange Commission which pointed out that the adoption of an absolute rule that failure to register rendered contracts unenforceable would in some instances operate to prejudice investors: for example, where investors had actually purchased securities from the underwriter and the underwriter refused to account to the issuer for the proceeds (See 312 U. S. at 43). Subsequently, in *Judson* v. *Buckley*, 130 F. 2d 174 (CA 2, 1942), cert den. *Buckley* v. *Judson*, 317 U. S. 679, the Commission filed a brief urging that the rule of nonenforceability be applied in a case where an actual misrepresentation had been made in a registration statement. The *Judson* case is discussed, *supra*, p. 13.

attempt by an issuer to collect damages from an underwriter who assumed the burden and risk of refusing to consummate a deal which, if carried out, would have resulted in the sale to the public of $10,000,000 of securities on the basis of gross misrepresentation of the company's earnings,[22] with consequent losses to the public running into the millions.[23]

The sale of securities to the public in these circumstances is the basic evil that the Securities Act was designed to prevent. This evil was not effectuated in this case because the underwriters were unwilling to accept and resell to the public the securities which Kaiser-Frazer sought to issue on the basis of false and misleading representations. The decision below will strengthen the fundamental purpose of the Act which is to prevent issuers from making false statements to sell securities.

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[22] Kaiser-Frazer's petition appears to suggest that the transaction in issue should be considered as a private bargain involving just the underwriters and the issuer, and not the public. The transaction in this case in all respects followed established forms and practices used in the underwriting of securities for distribution to the public immediately after the contract between the underwriter and issuer is signed. As the court below stated (R. 3098-99), and as is obvious from the nature of the transaction and the terms of the contract, the essence of the deal was a public offering to be made immediately after the registration statement became effective and upon its basis. Kaiser-Frazer was required to prepare and file a registration statement and prospectus which would be truthful and complete (R. 14, § 1(c)). It was to send copies of the prospectus to securities dealers designated by the underwriters and to furnish the underwriters with such further copies "as may be required for use in connection with the public offering of the Shares" (R. 17, §§ 2(d) and (f)). The registration statement and prospectus showed the public offering price which was based on the market at the time the statement became effective (PX 2, p. 1, R. 2585). The court below was clearly correct in stating that the contract between the issuer and the underwriters "was but the initial step in the public offering of the securities which would necessarily follow" (R. 3098-99).

Kaiser-Frazer's suggestion that the registration statement could have been amended presumably after it became effective and before public offering, is contrary to the contract and to the essential mechanics of securities distribution. Time was of the essence as is customary in a transaction of this sort. The securities had to be sold when planned. The price was fixed on the basis of the market at that time. It is for that reason that, as we have emphasized, Kaiser-Frazer warranted as a condition of the underwriters' obligation that the registration statement would be truthful and complete *when* it became effective (R. 14, § 1 (c)).

[23] The stock which was to be sold to the public at $13 per share declined to below $3 per share and the company had losses of $39,000,000 for 1949 and $20,000,000 in 1950 (R. 1931). The present market is between $4 and $5 per share on the New York Curb Exchange.

The Act places the obligation for full and accurate disclosure squarely upon the issuer (§ 6(a), 15 U. S. C. § 77 f (a)). The issuer must prepare, sign and file the registration statement, and is subject to criminal as well as civil liabilities for any misrepresentations that are made (§ 6 (a), 24, 17, 11, 15 U. S. C. § 77 f (a), x, q, k). The Act charges the underwriter only with the responsibility for "reasonable investigation". The underwriter is not criminally liable, and is civilly liable to investors only if it fails in its obligation of "reasonable investigation". (§ 11 (b) (3), 15 U. S. C. § 77 k (b) (3)). Even in such case it may, according to the statute, obtain "contribution" from the issuer (§ 11 (f), 15 U. S. C. § 77 k (f)).[24]

In short, the objective of the law is to insure that issuers refrain from misrepresentations and concealments, and to encourage underwriters to refuse to market securities where the issuer has not fully complied with this obligation. The holding below effectuates this policy by denying the aid of the courts to issuers who have violated their moral, legal and contractual duty and by encouraging underwriters to refuse to proceed with the sale of securities to the public in those circumstances. The contrary ruling urged by Kaiser-Frazer would defeat that policy. It would lend the aid of the courts to issuers who have violated the basic requirement of the law and public policy, and would subject underwriters to peril and penalty for refusing to consummate a fraud on the public.

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[24] The underwriting contract in this case reflects and reinforces the plan of the Act by the following provisions: (1) The issuer warrants that the registration statement and prospectus will be complete and accurate, and this is a condition of the underwriters' contractual liability (R. 14 § 1 (c), R. 20 § 3); (2) the warranties of the issuer remain fully operative regardless of any investigation made by or on behalf of the underwriter (R. 25 § 4 (a)); and (3) the issuer agrees fully to indemnify the underwriter if it is subjected to liability on account of any representations or concealments by the issuer in the registration statement or prospectus (R. 24, § 4 (a)).

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

ABE FORTAS,
MILTON V. FREEMAN,
Attorneys for Respondent.

BEN HERZBERG,
LAWRENCE R. ENO,
ARNOLD, FORTAS & PORTER,
Of Counsel.

August 1, 1952.

Office - Supreme Court, U. S.
FILED
AUG 14 1952
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 123.

KAISER-FRAZER CORPORATION,
Petitioner,

against

OTIS & CO.,
Respondent.

PETITIONER'S REPLY BRIEF.

JOHN W. DAVIS,
Counsel for Petitioner,
Kaiser-Frazer Corporation.

MARK F. HUGHES,
WALSTON S. BROWN,
GEORGE EDWARD COTTER,
HELMER R. JOHNSON,
VINCENT R. FITZPATRICK,
RICHARD OWEN,
Of Counsel.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

Table of Cases.

	PAGE
Bennett v. *Buchan*, 76 N. Y. 386	2
Frost & Co. v. *Coeur D. Alenes Mines Corp.*, 312 U. S. 38	3

Statutes and Rules.

Federal Rules of Civil Procedure, Rule 52(a)	3
Securities Act of 1933, 48 Stat. 74 (1933) 15 U. S. C. Secs. 77a-77aa	1, 2, 3, 4
Securities Exchange Act of 1934, 48 Stat. 881 (1934) 15 U. S. C. Secs. 78a-78jj 15 U. S. C. Sec. 78j (Section 10b)	3

Other Authorities.

Williston on Sales, Sec. 207, Rev. Ed.	2

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Respondent's brief attempts to create a wholly false impression as to the purport of the decision of the court below.

In its statement of questions presented (Br.[1] 2) respondent says that the case involves the question of whether a certain claimed failure of disclosure in a prospectus involved "a violation of the Securities Act of 1933 and of the warranty of the contract". There is nothing in the opinion of the Court of Appeals which either expressly or by implication could be construed as a determination that the defense of breach of warranty was available to respondent. To the contrary, it was implicit in the opinion that this defense was not available to respondent. The sole ground for reversing the decision of the District Court was that

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[1] Reference is to pages of respondent's brief dated August 1, 1952 in opposition to the petition.

the contract was illegal by virtue of the provisions of the Securities Act of 1933.

The Court of Appeals found the Prospectus misleading in one respect only, that is, the manner in which earnings for the last quarter of the year 1947 were represented. In respect of this portion of the Prospectus, the Court of Appeals stated "representatives of Otis [respondent] at least were informed of the actual December earnings and apparently took part in the preparation of the registration statement and prospectus"[2] (R. 3098). The court then proceeded to state that the knowledge of Otis was immaterial since the contract was illegal by virtue of the provisions of the Securities Act of 1933.

Respondent states that the contract would have been illegal even in absence of the Securities Act of 1933 (Br. 12, 14). There is nothing in the decision of the court below to this effect. Furthermore, this argument is based upon an assumption of facts not involved in the present action.

A considerable portion of respondent's brief (Br. 3-8) is devoted to the claim that petitioner concealed the true conditions of its sales and a downward trend in its earnings. This claim was made by respondent both in the District Court and in the Court of Appeals. The District Court specifically found against this claim (R. 3067, 3077-79). Its findings were based on extensive evidence (R. 1358, 1443-80, 1568-1603, 1825-43, 1849-57, 2101-11, 2139-2204, 2757; Plaintiff's Exhibits 2, 97, 98, 101, 103, 105, 107-120, and Defendant's Exhibits 31-73, 79-83, 103, 137-147, 199-211). These findings were left undisturbed by the Court of Appeals.

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[2] These documents were prepared prior to the execution of the contract. Clearly, if respondent had full knowledge of the facts claimed to have been misrepresented therein, the defense of breach of warranty would not lie. *Bennett* v. *Buchan*, 76 N. Y. 386 (1879); *Williston, Sales*, Section 207, Rev. Ed.

Throughout respondent's brief it is implied that petitioner was guilty of wilful fraud or misrepresentation. For instance, the transaction is referred to "as an attempt to defraud the public" (Br. 15). A claim of fraud was made before the District Court and the District Court rejected it (R. 3068). Nothing in the decision of the Court of Appeals even indicates that that court considered that there was any fraud or wilful concealment.

In the light of these facts respondent's argument that the contract could have been held illegal on the basis of some general public policy (Br. 12) or under the provisions of Section 10(b) of the Securities and Exchange Act of 1934 (Br. 14) is totally lacking in merit. In absence of fraud, neither basis would exist for holding the contract unenforceable.

Under such circumstances, therefore, the Court of Appeals based its decision solely upon the assumption that the Securities Act of 1933 rendered the contract illegal and unenforceable. In so doing, it held that a contract which was legal and valid on its face would not be enforced because that Court believed that its performance would involve a violation of the provisions of the Securities Act of 1933. That is precisely what this Court held to the contrary in the case of *Frost & Co.* v. *Coeur D'Alenes Mines Corp.*, 312 U. S. 38.

As to the failure of the Court of Appeals to comply with the requirements of Rule 52(a), respondent (Br. 10) inaccurately states that there were no disputed questions of fact before the District Court. The facts as to the proper presentation of earnings were in dispute before that Court. As shown in the petition (p. 16) there was substantial evidence that such earnings were presented in accordance with good accounting practice.

Respondent (Br. 9) fails properly to present the Court of Appeals' interpretation of the requirements of the Securities Act of 1933. Were the facts as stated by respondent, there would be some basis for the argument that such requirements had not been complied with by petitioner. However, as pointed out in the petition (pp. 19-22), these were not the facts and the sole ground on which the Court of Appeals concluded that the Act was not complied with was that a footnote, which stated that substantial adjustments had been made, was not, in its opinion sufficiently explicit.

Respectfully submitted,

JOHN W. DAVIS,
Counsel for Petitioner, Kaiser-Frazer Corporation.

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WALSTON S. BROWN,
GEORGE EDWARD COTTER,
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